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ECONOMIC PROBLEMS  
OF  
PEACE AFTER WAR

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ECONOMIC PROBLEMS  
OF  
PEACE AFTER WAR  
(SECOND SERIES)

THE W. STANLEY JEVONS LECTURES AT  
UNIVERSITY COLLEGE, LONDON, IN 1918

BY

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Adam Smith Professor of Political Economy in the University of Glasgow  
and Fellow of the British Academy

Cambridge:  
at the University Press  
1918

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Never doth an important truth spread its roots so wide, or clasp the soil so stubbornly, as when it has braved the winds of controversy. There is a stirring and a far-heard music sent forth from the tree of sound knowledge, when its branches are fighting with the storm, which passing onward shrills out at once truth's triumph and its own defeat.

S. T. COLERIDGE.



## PREFACE

IN the previous course of lectures an effort was made to indicate some of the chief principles which should guide us in contemplating the economic future. The general conclusion which resulted was that emphasis should be laid upon general rather than on particular tendencies. It is to be feared that much of the planning which has been undertaken during the war has been weakened, and some of it wasted, through an undue concentration upon details and the neglect of wide and comprehensive principles, many of which are psychological, rather than purely economic. It may seem almost a paradox to say that what is most important in facing the future is first to reach the right point of view. Accordingly, all that was possible in the former series of addresses was to seek for the proper attitude of mind towards the problems with which the country will be confronted. It was not possible upon that occasion to do more than to suggest in a tentative manner how the general principles should be applied to special cases.

In the ensuing pages concrete illustrations are afforded of the working of this method. It has been by no means easy to select the particular topics to be treated. Many economic problems arose and were alluded to in the course of the previous discussion. From amongst these it seemed, on the whole, that it would be most advantageous to concentrate attention upon two groups of questions. One of these is concerned with the economic considerations connected with the project of a League of Nations—partly as to its feasibility, partly (assuming it to be possible)

as to its consequences upon commerce and particularly in relation to communication by land, sea and air. These and other matters of a similar character are discussed in the first two lectures. The remainder deal with problems of finance. There is no field of economic enquiry where the need for investigation is more urgent. Here, in particular, according to the saying of Leibniz, "the present is full of the future." To a large extent what we do now is determining what we must do in the future: while what we abstain from doing now will have no less striking effects. Finance since the beginning of the war and until a number of years after peace has been re-established constitutes a unity, but it is a unity part of which (namely the interval between the present time and the cessation of hostilities) is partly hidden from us. In dealing with the position as a whole an attempt has been made to allow for this inevitable uncertainty. Several aspects of the position have been grouped together for separate treatment—as, for instance, the principles which should govern war finance in relation to the debt for which we shall be liable when the war is ended, next various schemes for the reduction of the war debt are discussed, and after that certain characteristics of what may be termed the period of financial transition, that is the interval from the declaration of peace until the finances can be considered normal again, finally if the imagination be carried forward into the earlier years of peace, certain of the problems which will then be pressing can be anticipated. As regards this part of the work it may be mentioned that the manuscript was in the hands of the printer before the Budget statement was made. Under the circumstances it did not appear that any alterations, beyond the inclusion of some later figures, were called for; since I judged it best to present what had been written in its original form as an independent review of the situation. It may perhaps be of

interest to state that the calculations, which led to fixing upon the sum of 900 millions as the amount which should be aimed at from taxation and State services in 1918-19, were made in September-October of last year and this result was announced at a lecture given to the Royal Philosophical Society of Glasgow in November. That happens to be the sum which Mr McKenna and the other members of the House of Commons, who have given special attention to financial questions, estimate as the revenue in a complete financial year under the present Budget (*Hansard*, 103, pp. 724, 780).

The expansiveness and the solidity of the British finances have been remarkable. Hitherto any reasonable estimate of future revenue, however optimistic it may have seemed at the date it was made, has fallen short of the reality. At the same time due weight must be given to the present exceptional circumstances. From the financial point of view the situation may be compared to that of a person who has to make extraordinary efforts and is kept going by a powerful tonic. The disbursement of immense sums of borrowed money and the state of the currency as well as the exceptional nature of war time trade may be compared, not inaptly, to the tonic in the illustration. But the question arises what is to happen to the revenue and to the financial system generally when the time comes at which the tonic can no longer be given? An earnest effort has been made to face this problem in the last two lectures; and, given reasonable care and prudent management, the result is far from discouraging. But war time extravagance has become almost the habit of some of the great spending Departments of the Government, and the restoration of reasonable economy will be necessary, indeed the financial position after the war cannot justly be described as normal until this has been accomplished. The country has ample resources for the maximum necessary

expences of its defence against a system which would render its free development in industry impossible, but it has not resources to waste, unless its recovery from the material losses of war is to be unduly and even painfully protracted.

As the great struggle works itself out to the one inevitable end, the nation like Sir Beaumains in the *Morte D'Arthur* must win through "the pass perilous," not once but many times. Finance is an essential element in the contest. Its function is to maintain the fullest efficiency of the fighting forces with the least detriment to the future. The former condition must of necessity be supreme, but at the same time due attention should be paid to the second.

The final result of the financial investigation shows that, if the system be used judiciously, there are no grounds to fear interruption of a vigorous conduct of the war through failure of adequate resources. Still less is there reason to expect that the burden of taxation which the war will leave behind it—heavy as this must be—will prove intolerable. It appears as clear as any thing can be during the uncertainties of a state of war that, given prudence in the use of our financial resources, those who predict either financial exhaustion during the war or financial collapse after it are ill-informed in their despondency. Theirs is that sad failure of vision which may be imagined almost to repeat the words of Timorous and Mistrust "the further we go the more dangers we meet, wherefore we would turn, and go back again."

W. R. S.

*April, 1918.*

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In previous wars enemies, who felt the effects of British sea power, have advocated "Freedom of the Seas": only a few years after the end of the Napoleonic wars I. Disraeli included an account of the French arguments on this subject amongst his "Literary curiosities": the German conception as developed by Schulze-Gävernitz and Reventlow: the position of Grotius: his anticipation of aerial navigation: Gronovius on the *jus gentium* and free passage through the air: the question of the use of the air over the land by foreign nations: the ideal of making navigation by air as free as that upon the sea before the war: the danger of territorial exclusiveness aiming at a doctrine of *aer clausus*: international regulation of navigation by air: Kipling's A.B.C.: the proposed League of Nations and regulation of aerial traffic: the limitation of the air service, if impeded by territorial exclusiveness: possibilities of political friction in relation to trade routes: the function of the proposed League regarding these: the League and the use of the air for purposes of war: the effect of control of communication by land, sea and air in enforcing peace . . . . . p. i

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MARE LIBERUM—AER CLAUSUS?

Men cannot conceive a state of things so fair that it cannot be realised.... What can be expressed in words can be expressed in life.

H. D. THOREAU.

Dear Child, I also by pleasant streams,  
Have wander'd all night in the land of dreams,  
But though calm and warm the waters wide,  
I could not get to the other side.

WILLIAM BLAKE.

## MARE LIBERUM—AER CLAUSUS?

THE change from peace to war has not only been reflected in military preparations and all the industrial processes which are consequent upon them, but it shows itself in a more subtle form in an alteration in the direction of mental activity. The mind turns inevitably to a changed adaptation of means to ends and also to consideration of more general issues which have arisen out of the new state. When people generalise, the diversion of human energy and its more immediate consequences invite, and even compel, reflection. The same situation may be noticed in previous wars; but, after the long peace, the old discussions, which re-emerge after a long interval, come to us as wholly new and as views or problems which must be dealt with afresh. An instance of this tendency is to be found in the revival in other countries of the contention, known as "the Freedom of the Seas." In the past almost every enemy that has felt the effects of naval power, has made similar claims. This is not to be wondered at. On the contrary, it is natural that a nation at war should endeavour by argument to depreciate, and if possible to weaken those means of offence which his adversary possesses and in which he himself is relatively weak. Dutch jurists made a case against us in this connection in the seventeenth century, largely in relation to fishing. In the Napoleonic Wars freedom of the seas was advocated by the French and supported by similar arguments, often with considerable emphasis—a polemic which made so little permanent impression upon British thought that Isaac Disraeli, writing soon after Waterloo, included it amongst literary curiosities<sup>1</sup>. It is almost brutal criticism to have noted such special pleading as a mere literary curio! From that point

<sup>1</sup> Disraeli, *Curiosities of Literature*, 1859, II. p. 79.

of view the former arguments, again revived, may have acquired greater interest through their greater age; though, necessarily, unless some new conditions have emerged, these arguments will be less, rather than more cogent. Still, in view of the renewal of this old controversy and particularly the form in which it has reached the general public of this country through many eloquent addresses from our kinsmen and allies in the United States, it may be worth re-stating the issue and examining it in the light of modern facts and possibilities.

In a lecture of the previous course I attempted to outline the conditions which have brought British sea-power into existence<sup>1</sup>. As long as the commonwealth of British peoples continues as a maritime state, security of intercommunication between its ports is unconditionally necessary. In war it becomes a cardinal part of the nation's strength, and one which, in the end, may be expected to justify to the full all that Mahan has said of its decisive character. Any type of thinking which would limit the use of the Navy in war, save under considerations of humanity, would be a great wrong not only to the people of this country and of the Dominions but to our Allies as well. To fail in making the most efficient use of an instrument bequeathed to us by our fathers and improved by the sacrifices of the present generation in preparation for the possibilities of defence, which have now become actual necessities, would be the fatal error for which there would be neither excuse nor forgiveness.

While the position during hostilities is perfectly unambiguous, it may be inquired whether, when we consider the prospects of the earlier years of peace, there has been any new condition which may conceivably modify our former views upon the nature, the necessity and the use of our sea power. British and Allied war aims have placed in the forefront their demand for the freedom of small nations. For close upon three quarters of a century Great Britain has stood for free enterprise and for freedom of trade. It may seem symmetrical to add to the ideals of freedom of nations and freedom of enterprise, a third freedom—that of the seas. As regards the first two the signification of

<sup>1</sup> W. R. Scott, *Economic Problems*, First Series, pp. 49, 50.

the terms is known, but those who use the third have shrouded their meaning in obscurity. During peace not only has there been unrestricted freedom of navigation, but British sea power, so far from limiting that freedom, has extended it, first by repressing piracy, secondly by improving navigation and thirdly by making it more safe through charting various imperfectly surveyed waters, all of which activities have been for the common benefit of all sea-faring nations. It follows that no greater freedom of the seas can be conceived than that which existed during peace. Is it claimed, then, that a similar freedom can be maintained in time of war? Mr Woodrow Wilson pictures an "inviolable security of the highway of the seas for the common and unhindered use of all the nations of the world," while many German writers have claimed during the last three years a freedom of the seas in time of war, which freedom Professor von Schulze-Gävernitz specifies as meaning the inviolability of private property at sea in time of war, as well as during peace. The latter claim is contrary to the practice of all maritime nations in the past. It would not only raise an infinity of confused legal questions, but it would deprive the proposed League of Nations of one important power which it has been suggested to give it. According to the methods to be described in the next lecture, that body would be able to bring pressure to bear upon any State which attacked a nation which had joined the League and also upon a signatory Power which refuses to submit a dispute to arbitration or does not carry out the award of the tribunal of the League. One form of the coercion exercised by the proposed League would be by interruption of the commerce of the recalcitrant State, and for this purpose it would be necessary that it should be able to control, and divert the sea borne commerce of its members. Thus if the thesis of freedom of the seas be accepted in the sense of the complete inviolability of private property at sea, the League of Nations either could not exist as a body with coercive powers, or else it would be compelled to rely exclusively upon military force.

This view, inadmissible as it is in the general interests of the seafaring nations, is refuted by the full claims of German

ambition when it is allowed free expression. Lord Robert Cecil quoted in the House of Commons the following definition by Count Reventlow at a meeting which the latter addressed at Berlin in March 1917, "What do we Germans understand by the freedom of the seas? Of course, we do not mean by it that free use of the sea, which is the common privilege of all nations in time of peace—the right to the open highways of international trade. That sort of freedom of the sea we had before the war. What we understand to-day by this doctrine is that Germany should possess such maritime territories and such naval bases that at the outbreak of war we should be able with our Navy ready, reasonably to guarantee ourselves the command of the seas. We want such a jumping off place as would give us a fair chance of dominating the seas<sup>1</sup>." In this sense freedom avows itself, naked and unashamed, as freedom to dominate. It resembles the meaning which the Jacobins assigned to fraternity when they always thought of themselves as the elder brothers<sup>2</sup>.

Some light upon the conception of the freedom of the seas may perhaps be obtained by a study of the early ideas from which it has been evolved. Grotius published his tract, called *De Mare Libero*, in 1606. His object was to establish by argument a right which English seamen had partially justified by arms in the previous generation, namely, that in time of peace no nation was entitled to close the open sea to the ships of other countries. This controversy had special relation to the reservation of the trade to the East Indies by the Portuguese. Grotius was far removed from those who advocate freedom of the seas in the interests of peace. On the contrary the Elzevir edition of his treatise, printed in 1633, has an engraved title page exhibiting a heavily armed ship flying the flag of the United Provinces, and he declares that the refusal of free passage of merchandize by sea constitutes a just cause of war<sup>3</sup>. In expounding these ideas, Grotius enunciates certain general principles, and some of these, when taken apart from their context, have been used to support

<sup>1</sup> *Times*, February 15, 1918.

<sup>2</sup> *Guesses at Truth*, 1873, p. 31.

<sup>3</sup> *De Mare Libero*, XIII.; cf. *De Jure Belli*, ii. II. 13; ii. III. 12.

conclusions which he did not accept and which, moreover, are contradicted either explicitly or implicitly elsewhere. That the sea should be free or common to all is defined as applicable to an unarmed navigation which does harm to none<sup>1</sup>, in which it resembles free passage for private persons in foreign countries. While, according to the *jus gentium*, there could not be "acquisition" of the open sea, there may be dominion (*imperium*) over it, to which he does not consider the *jus gentium* would offer any impediment<sup>2</sup>. Dominion of the sea is acquired when a fleet is able to command it. This requires an external act and only remains as long as that act continues. Gronovius makes this more precise by particularising the external act as the presence of the fleet which commands the sea and which lapses when that command ceases. Thus the conception of the *mare liberum* involves nothing which is inconsistent with British practice for many generations, nor when peace returns does there appear to be anything which, in principle, would preclude the former freedom from being restored. Indeed, when in 1750 Frederick the Great advanced the doctrine that "the sea is free," the British law-officers were able to quote Grotius against him and in defence of the action of the fleet which had occasioned the protest and reprisals<sup>3</sup>.

We are prone to speak of peace as if it were a "stationary state," whereas it has been hitherto a condition arising out of a series of tensions, some of which are always operating towards a disturbance of the equilibrium. It is to be hoped that the new peace can be established upon a basis which will provide self acting methods for checking and, if possible, in the end eliminating those tendencies which work towards disturbance of good relations between nations. Many earnest efforts have been made to discover those influences which seem to threaten discord. Enthusiasm for the prevention of future wars has discovered possible causes of friction in some unsuspected places, often

<sup>1</sup> *De Jure Belli*, ii. iii. 13.

<sup>2</sup> *Ibid.* ii. iii. 14. The phrase is *neque arbitrator jus illud gentium, de quo diximus, obstaré*.

<sup>3</sup> *Law and Custom of the Sea* (Navy Records Society) 1915-16, II. p. 370.



with more haste than discernment. One of these has been found in the British Navy. The argument may be summarised as follows. The Allies have declared that one of their chief objects is the freeing of the world from the menace of German militarism. The Germans, on their side, have complained of British "navalism." Thus to some it seems that a compromise is possible in a League of Nations, which, together with the growth of opinion in each country, would impose limits upon both forms of power. In an extreme form there are some who would bid for Germany's adherence to the League by advocating limitation of our sea power in advance of it<sup>1</sup>. It seems to me that this line of thought neglects the history and particularly the recent applications of the two forces. Militarism is a survival of the feudal age, and it is working out its own condemnation before the conscience of a disapproving world. The Prussian view of British and Allied sea power is that it is "naval militarism," which it is not, either in its object or its methods. To confound two things so different will not be, in the end, the way to peace:

Such handsome words  
Are now as if one bound up wounds with silk  
Or with fine knots, which do not help the cure,  
Or make it heal the sooner<sup>2</sup>.

In the forefront of peace conditions, as far as Great Britain is affected, must be security. Attention has already been directed to the importance of trade routes between the peoples that constitute the British Empire<sup>3</sup>. War upon land has perhaps distracted popular attention from the fundamental condition of the union of British peoples. For other countries with colonies the means of communication by sea are important, but to us they are the life nerve of the State. If these be endangered, the safety of the whole would be in jeopardy. Thus it was with a true insight that Pitt described "naval defence as our national passion<sup>4</sup>." No League which ignores or undervalues this prime necessity would be acceptable to Great Britain.

<sup>1</sup> H. N. Brailsford, *League of Nations*, 1917, pp. 187-209, 213-17.

<sup>2</sup> Suckling, *The Goblins*, Act II. Scene I.

<sup>3</sup> W. R. Scott, *Economic Problems*, First Series, p. 50.

<sup>4</sup> Pitt, *Works*, II. p. 299.



The problem of the conditions of a durable peace will be found to be bound up more and more with trade routes and communication generally. These are of equal importance, whether upon sea or land, and both are becoming of greater interest to all trading nations. There is no question that traffic by sea is more free than that by land. In the case of the latter there are numerous impediments of various kinds which could be materially reduced. And it will not be long before the problem of communications by air must be considered. In the work of Grotius there is a suggestion which has lain dormant for over three hundred years, waiting on the progress of invention. He mentions that the air is common to all, like the sea, in so far as there is any use for it for which the earth is not necessary<sup>1</sup>. It is added that no such use had been discovered, but Gronovius suggests the *jus gentium* would ordain free passage through the air over the land *si homines possent volare aut versare in aere, sine tactu terrae vel molis quae a terra sustinetur*<sup>2</sup>, a remarkable provision for the developments in flying which have taken place recently or which are already in sight. Thus the problem of communication in the future is one which cannot be confined to that by sea and land but will embrace to a greater and greater extent the use of the air over both. It follows that the first question to be decided after peace will be the "freedom of the air." Even already there are indications that the postal service will be transferred in part from railways to the air. The gain in speed will compensate for the greater cost of the new service in its initial stages. It may not be long before some urgent passenger traffic will follow. The new air routes can be made more direct; but to those who have been trained in continental ways of thinking there will be difficulties. There may be a reluctance to permit the unrestrained use of the air within territorial limits to the air craft of foreign nations. Customs barriers, which will still exist, can no longer be enforced in the present form, nor could the service be efficient, if it worked by the transfer of mails and goods from the air-liners of one country to those of another at the frontier. Thus

<sup>1</sup> *De Jure Belli*, ii. 11. 3.

<sup>2</sup> *Ibid.* ed. Gronovius, 1689, p. 186.

there is a danger that Europe may be robbed of a great part of the fruits of recent progress in aerial invention by territorial exclusiveness. Accordingly the most urgent question is to provide for a freedom of the air in time of peace which will in some measure approximate to that which existed before the war in navigation upon the sea. A doctrine which resembles that of *mare clausum*, as applied to the air in time of peace, may have to be reckoned with. Yet it is one which is in danger of involving itself in endless contradiction. The air is one, and no distinction can be maintained between that part of it which is above the land as contrasted with the portion over the sea. For purposes of use in communication both are continuous except in so far as landing places will probably be provided in the former only. At this point there may be misunderstanding and no little real difficulty for countries whose system has been exclusively or mainly that of the land Power. No doubt it will happen that some of the air routes will pass over the territory of small nations or over corners of that of large ones without requiring to make use of landing facilities. In the event of some of the smaller goods of large value being carried by air, those of them which are subject to duties, would escape the inquisition of the respective Custom Houses, and the States concerned would lose revenue. Moreover navigation by water is largely confined to one plane, and probably for commercial purposes it will continue to be limited to that plane. But in the air, flying can be effected at widely varying altitudes. As its mechanism is perfected and traffic in the air becomes more dense, there would be great advantages in safety by assigning specific heights for incoming and outgoing traffic, while the craft could again be sub-divided according to their speed and separate strata of the air allocated to each class. This points to some degree of international agreement upon this and similar subjects. In a story published only a few years ago, Mr Kipling presents a wonderfully realistic picture of the aerial mail from London to Quebec in the year 2,000. It seems possible that, as a result of the importance of the air service in war, this vivid representation of the future may be realised, at least in part, much sooner than the author himself expected. That tale

anticipates that communication by air will be under the direction of an international Aerial Board of Control—the A.B.C. of the tale<sup>1</sup>. May it not be that in this, as in some other cases of late, the imaginative writer has been able to divine to some extent the general appearance of coming events? It certainly appears that, for flying to become useful for the purposes of every day life, a measure of international agreement will require to be reached which must consider more matters and of greater complexity than has been the case in navigation by sea.

Upon the assumption—and it is no small one—that some form of international agreement for the general use of the air in time of peace will be arrived at, the next step will be to make the new “navigation” as free as that of the seas. There may be communication by flight without there being “Freedom of the Air.” States with the continental spirit will be able to appreciate the extent of the freedom of marine communication when it devolves upon them to endeavour to equal it in the case of the air, where they will be in the position of conceding something, instead of claiming much.

Great as is the hope of the best minds, both in belligerent and neutral countries, that this war will end in a durable peace, it would be extravagant optimism to expect that the goal of perpetual peace will have been reached. As far as can be judged at present, should war unfortunately come again, no power could permit unrestricted flight over its territory. No doubt the new “navy that flies” would not only endeavour to drive off all air craft of hostile powers, but it would be likely to suspend even neutral traffic which would be able to observe its dispositions during hostilities. Also it would aim at securing observation and interrupting commerce with countries hostile to it. Such conditions reproduce upon a somewhat intensified scale those of modern naval operations. In war the air, like the sea, would be free to those who can control it and to such neutral States as they admitted to participation in that freedom under the rules and conventions of International Law.

War and Peace are not final antitheses. Each may be regarded

<sup>1</sup> Kipling, *Actions and Reactions*, 1909, pp. 111–158.

as a transitional state towards the other. But no one, who is in earnest with the hope of progress, can accept this transition without endeavouring to modify it in favour of peace and against war. In the future economic difficulties and questions of transport will play an increasing part, either in dividing or in uniting the nations. Some of the difficulties of the former will be discussed in the following lecture, and it remains to treat the position of transport in the new peace. Communication alike on the land, the sea and in the air has a distinct bearing upon national security and offensive power. The construction of strategic railways is an instance of the first. The limitation of armies might prove illusory, if, at the same time, any Power built a large number of strategic lines, thereby increasing the combatant efficiency of a reduced number of soldiers. Yet there are few who would suggest any practical measures by which the League of Nations, if it is established, could prevent this policy. There may however be a better way, if the League could be successful in removing, or at least weakening, those causes which lead to preparations for military aggression.

The problems of sea and land communication are sufficiently numerous when the varying interests of the whole world are considered. And to these there is now added those that arise from man's coming conquest of the pathway of the skies<sup>1</sup> for peaceful progress, not for purposes of destruction. Before this new wonder we may well feel something of the "wild surmise" with which the companions of the stout Cortez of Keats first stared at the Pacific "silent, upon a peak in Darien."

It has already been shown that aerial traffic will require a considerable amount of international regulation: and, upon the supposition that an effective League of Nations were established, this body would be in a position to facilitate agreement, and in it certain aspects of control might be vested. The particularism of land Powers would be an obstacle which could only be worn down gradually. At first communication by air would be much less free than that by sea, and it would be a worthy object for the League to aim at making it as free as that upon the ocean. **At**

<sup>1</sup> ἴν' οὐρανὸς ἀμβρατὸς εἴη, *Homer, Odyssey*, xi. 316.

sorts of impediments may be expected, for many States will not be able to accomplish at one leap the mental revolution of thinking in terms of right, instead of in terms of force. But the idea of the general advantage, applied from the beginning, would save many millions in capital which would otherwise be wasted. If the new routes are deflected through territorial objects, landing places and entrepôts will be built in situations which are not those which freedom of the air would justify. Thus a later and more enlightened attitude would render all such special outlays obsolete. There seems to be a great opportunity here. Wisdom and a broad view of the future could contribute very much, not only to the progress of the arts of peace, but even more to the slow building up of a sense of international solidarity in Europe. A certain diversion of traffic may be inevitable, but as was shown in the previous course of lectures<sup>1</sup>, this may be less than might be anticipated. Apart from territorial exclusiveness, the doctrine of the continuous voyage may be no less difficult in this connection during peace than it has proved in the case of mercantile shipping in time of war.

When an attempt is made to work out some of the implications involved in the idea of a League of Nations, it will be found to tend to unify aspects of communication that have previously been divergent. From the purely economic point of view transport, whether by land or sea or air, is fundamentally one, but the cross currents of politics, as hitherto conceived, have isolated each according to current views of national advantage. Should a League of Nations become firmly established, it might, in time, be able to overcome this unreal separation of things which are essentially similar. In the past the extent to which land routes and sea routes were capable of being substituted, the one for the other, was limited. The introduction of a new medium of communication for certain kinds of traffic will extend the area of competition to an immense extent. But the growth of substitution will not in itself remove all political difficulties in the extending of freedom of intercourse; for in some respects, the control of internal transport may still be considered vital for the maintenance

<sup>1</sup> W. R. Scott, *Economic Problems*, First Series, pp. 55, 56.



of the structure of the State. It could scarcely be expected that a self-respecting land Power would hand over the ownership and working of its railways either to a foreign State or to a League of Nations. Yet if an air service is conceived upon such territorial principles, it will be a failure as compared with what it might achieve. From the political and also the economic point of view a maritime State must control the ocean routes by which its parts are linked together. If these can be permanently interrupted its whole existence is endangered. As they are safeguarded and improved the unity and cohesion of the British peoples are augmented; and, as flight is developed, these unifying forces will grow with a rapidity which is yet scarcely anticipated.

The reign of force has perverted many things to evil uses—and not the least of these the beneficent power of transport. Strategic railways and military lines represent a perversion of the mechanism of communication. It is difficult during a time, when the description of industrial activity tends almost inevitably to express itself in terms of destruction, to imagine conditions in which the aim of statesmen will be to reverse all this. Yet if the idea of the League of Nations means anything practical, this should be its chief aim. In so far as it can remove or diminish friction, which arises from competitive claims to trade routes, it would begin to justify itself. If it fails in this, it will not be long before it fails altogether. But it is probable that, if it is established, neither success nor failure would be reached at once. The first could only be built up slowly, and perhaps painfully, through several generations. During that period force would remain in the background, no longer to be used by any nation at its pleasure, but as the instrument of enforcing what the comity of nations held to be right. International law would not only be re-instated, but indued with sanctions. At first no one could predict with certainty whether the pact would be strong enough to bear the strain. A rupture or the dissolution of the League would remain for some time a possibility in all international questions. None the less, if it maintained itself and after at first enforcing peace in case of need, it came later to *win* peace by the extending of mutual confidence and conciliation,

then the leagued peoples would depend more and more upon the power of a just cause than on their individual armed force. At this later stage grounds for quarrel would not indeed be eliminated, but they would yield more easily to peaceful settlement. So it may be imagined that it will be under some such conditions that the problems of communication will require to be dealt with for as long a period as it is possible to survey, should the League continue and become firmly established.

In face of the wonder of flight and the vast field of possibilities which it opens up, any anticipation of what the future holds is hazardous to the verge of rashness. "'Tis a strange thing, and hath the look of a premeditation of fate to discredit our forecasting, how rarely the thing we confidently expect comes to pass<sup>1</sup>." In circumstances so new and, as yet, so strange, no forecast can be made, but there is a line of enquiry which may not be wholly profitless. If it be assumed that a League of Nations will be established, what should be its relation to communication by air with a view to increasing the prospects of peace? This cannot be described as a speculative enquiry, for aerial mail services are in operation and the carrying of passengers is understood to be under consideration. The causes of friction are numerous; and if the whole question is left to settle itself, this would mean in practice that the apparent divergence of national interests would, almost inevitably, re-assert itself, and some of the early troubles of navigation by sea would be repeated. Moreover, there would be immense advantages in favour of action by the League. Not only would it have a completely new field upon which to work, but the feverish activity during the war has compressed the inventive activity of more than a generation into a few years, without at the same time being able to utilise it for the purposes of civil life. Thus there is that exceedingly rare case of a clean sheet upon which to write the rules which will direct the use of the new medium for the common interest of all the nations. It is not to be expected that a final solution can be attained immediately. The first rules may soon need extensive amendment. Meanwhile invention will not have stood still, and

<sup>1</sup> E. H. Strain, *A Man's Foes*, p. 88.

it is not impossible that, by that time, some kinds of goods may be conveyed by air. This is a purely technical question upon which it would be presumptuous, as well as useless, to express an opinion, beyond pointing out that the bare possibility raises in a precise and definite form the problem of aerial trade routes. If the League of Nations could bring about international agreement concerning these, it would be in a favourable position to secure the observance of the conditions, and it would thus possess a great advantage over previous international conferences.

A still more thorny problem will be the attitude of the League to war in the air. Here the immediate prospects seem far from hopeful. One recalls the rule of the Hague Convention that explosives were not to be dropped from the air, and its complete non-observance by each belligerent. Unless the possibilities of aerial warfare are exploited to an extent which seems improbable in the present war, there will always remain the risk that a new invention may tempt an ambitious State to bid for the Lordship of the Air, which might mean the dominion of the world. And so the words of the Tempter may return in new conditions:

Aim therefore at no less than all the world

Aim at the highest, without the highest attained

Will be for thee no sitting, or not long<sup>1</sup>.

Also while the League is young, each Power must continue to provide for its own defence, and also for any demands which may be made upon it by the League; for, at first, the effectiveness of the new arrangement will be uncertain, and a nation which trusted to the maintenance of peace under the pact and abstained from taking precautions would find itself in a serious position, if the League were suddenly dissolved. If, on the other hand, the early years of this body inspired confidence and gave strong grounds for a belief in its continuance, it may be expected that armaments would be reduced. At this point, if it should be reached, there would be some prospect of dealing with the control of the air for purposes of war. It seems idle to anticipate that all Powers would agree to a self-denying ordinance to

<sup>1</sup> Milton, *Paradise Regained*, Book iv.



abandon aerial warfare altogether. The possibilities for observation and speed, as well as in actual offensive power, are too immense. Yet the prospect which is opened up is appalling. No place in any country, which was subject to attack by air, would offer safety to non-combatants, save at the cost of maintaining a precarious existence as Troglodytes. It is true that the League could ordain and might be able to enforce laws of aerial war, which would go far towards humanising it, but in time it might accomplish more. It would be a noble ideal if the conquest of this new element by man, won by the sacrifice of so many noble young lives, could be celebrated by reserving it from all future wars. For this purpose it is improbable that agreements would suffice. The extent to which the League could control communication by sea and air would be of the greatest importance when occasions arose in which it became needful to exert economic or military pressure upon a turbulent State. For the former the power to maintain an effective blockade would be essential. The freedom of the seas would come to be recognised as having been forfeited by any nation which had been adjudged in default by the Court of the League. The free use of the highway of the sea would be conditional upon the continued good behaviour of all those, who desired to avail themselves of it, according to the standard established by the great majority of the nations of the world.

The use of the economic boycott by the League is not free from difficulties. The present war has shown the extent to which small nations, with frontiers adjoining a powerful State, have been subjected to pressure. If these States were members of the League they would be supported by its resources, and it would depend upon the efficiency of the co-operation of the signatory States whether that protection was sufficient. It might happen that such small States had not joined the League; and, in that case questions of no little complexity would arise, as, indeed, they have arisen during the course of hostilities. The signatory States would all cut off commerce with the Power which was to be isolated. Further, would they be within their rights in taking care not to supply countries (which maintained trading relations

with the Power against which pressure was being exerted) with a surplus of their products which could be passed on to the isolated State? There is also the question of the action which it would be equitable to take with respect to shipping which was not under the control of the League. Suppose, for instance, that the economic weapon had to be used against a Power which owned five per cent. of the world's shipping, that States, not members of the League, possessed fifteen per cent., while the remaining eighty per cent. was under the direction of the League. Would the League be justified in limiting trade with countries which were not parties to the dispute? Or could it exercise any supervision over the voyages of these ships between the nation undergoing boycott and any or all non-signatory States?

These are only a few of the difficulties which can be seen at present, others would doubtless manifest themselves during the early years of the actual working of the League. It would be merely deluding ourselves to close our eyes to the many perplexing situations which would have to be encountered. The wisdom and the fairness of the decisions that will be arrived at would have a large place in determining whether the League would succeed. Judging its prospects upon the economic side, it may be said to offer a hope which is moderate. This may suffice as a start, on the assumption that certain governing conditions have been secured<sup>1</sup>. In a departure so new and so much opposed to the customs which have hitherto unfortunately prevailed in relations between nations, it would be dangerous to expect too much. Enthusiasm is liable to mislead. While one recognises, and sympathises with the devotion of those who have developed this ideal, the only test will be success in a hard world of somewhat intractable and even brutal fact. But men and nations have a large share in determining what will be facts in their mutual relations. For long these will be weighted with the legacy of the past, and it will be only gradually that the peoples of the world will become accustomed to a system which promises to be better. Even if progress is slow for some generations, this is of little importance, if it is sure. Work in favour of peace that

<sup>1</sup> See below pp. 26-28.

will be lasting will only begin to produce its best effects after a time that seems to our impatience to be very remote. Here there is consolation in remembering the illuminating saying of Plato that such an interval is as nothing as compared with eternity<sup>1</sup>.

Even if the proposed League should effect no more than the softening asperities, removing causes of quarrels, delaying appeals to arms, and sometimes compelling restless nations to abstain from hostilities, it would have accomplished much in preventing some small wars and perhaps one or two great ones. There is the hope that, in time, rudiments of morality may be introduced, as the standard, in transactions between nations. This affords some basis for the expectation that by a gradual, though slow, process of development there may be such security the world over as will stimulate industry in making full use of its powers for the common benefit of mankind.

<sup>1</sup> *Repub.* vi. 498 D: Εἰς μικρὸν γ' ἔφη χρόνον εἴρηκας. Εἰς οὐδὲν μὲν οὖν, ἔφη, ὥς γε πρὸς τὸν ἅπαντα.



A LEAGUE OF NATIONS AND  
COMMERCIAL POLICY

This League made glad the earth.

BARCLAY'S *Argenis* (as rendered by  
Sir Robert Le Grys and Thomas May).

## A LEAGUE OF NATIONS AND COMMERCIAL POLICY

FROM the economic point of view, no less than from the political one, security for the future is to be hoped from the upheaval of the nations. As Mill has said, "security has always hitherto characterized the progress of civilized society<sup>1</sup>": without it the rate of industrial advance would be checked, and it might even be arrested. In order that the material losses of war may be recovered as rapidly as is possible throughout the world, it is desirable that reliance can be placed upon the future. The tension of an uncertain peace would cramp resumed activity; and it would, still more, deflect the quickened spirit of discovery from the development of the arts of peace. Instead of winning its way to firm ground upon which to re-build what war had destroyed, humanity would remain involved in the shifting sands of suspicion and perplexity. It follows that the nature and the permanence of the peace will have important influences upon the economic life both of the present belligerents and of many neutrals. A settlement, which failed to offer guarantees for the future, would act as a weight upon the renewal of productive energy for the needs of peaceful pursuits.

The wish for a stable and abiding peace is universal, but there is no little difficulty in determining how it is to be defined and the manner in which it should be guaranteed. One method which has begun to attract attention has been the idea of a League of Nations. That ideal is a very old one. Its origins may be traced back to "the Truce of God" and the scheme of Gerolus de Regensburg in the twelfth century. It re-appears in "le Grand Dessein" of Henry IV of France, not long after the defeat of the Spanish Armada. From time to time, political thinkers have elaborated similar schemes, while in the nineteenth century the

<sup>1</sup> J. S. Mill, *Political Economy*, IV. 1, § 2 (ed. Ashley, p. 697).

general trend of British economic theory was in a similar direction, though it usually pointed towards a peaceful society of nations gradually becoming more united through mutual co-operation in the progress of industry. It is from this point of view that James Mill speaks of "that great Empire in the world at large of which the different kingdoms and tribes of men may be regarded as provinces<sup>1</sup>." The economic attitude differed from that of the political idealists in so far as it was not based on any action of governments but was supposed to accomplish its aim by the progressive improvement in the relations of nations through the growth of commercial intercourse.

The idea of a League of Nations is perhaps more a re-discovery than a revival of earlier forms of the conception. It no longer emanates from a spiritual power, such as the Church of the Middle Ages, nor from the diplomacy of monarchs. In its modern form it aims at being a court of free nations drawing its support and sanction from the people. The change in the form of expression is emphasized by the extent to which precedents for purely industrial conciliation have been drawn upon, as for instance when the British League of Nations Society affirms that all non-justiciable disputes between members of the proposed League "are to be referred to a Council of Inquiry and Conciliation, analogous to the bodies that have been created to deal with serious disputes between Labour and Capital." In many respects the British and American programmes for a League might be described as the Canadian Industrial Disputes Investigation Act of 1907 and the New Zealand Industrial and Conciliation Acts, 1908-1911, magnified from the comparatively humble sphere of industrial disputes to the immensely enlarged field of friction between nations. While some of these will continue to be economic, political difficulties will be more prominent, and often more dangerous. For such the economic precedent offers comparatively little help. Moreover, the analogy is incomplete in one direction. Where compulsory arbitration has been established in industrial disputes, an award has the prestige of the sovereignty of the State behind it. In the proposed constitutions

<sup>1</sup> J. Mill, *Commerce Defended*, 1808, p. 38.



of the League of Nations, sovereignty will continue to reside in the signatory States, and it will not be transferred to the executive of the proposed League. Some schemes have gone further than this. Long ago Cliffe Leslie foretold "the growth of law in a republic of nations." He adds "it will be objected that an effective international law involves a universal Empire, and the purchase of peace at the cost of the independence of nations. This objection rests on the assumption that sovereignty is of necessity indivisible and unlimited, and that a legislature for international affairs must consequently be either nugatory, or supremelike over the domestic affairs of nations; an assumption which we hope upon a future occasion to prove fallacious<sup>1</sup>." Though Cliffe Leslie would preserve the sovereignty of each nation in its internal affairs, it is evident that he regarded as essential the transfer of that part of it, which dealt with international relations, to "the republic of nations" of his forecast. A similar conception is to be found in the super-national authority which is proposed in the Draft Treaty of Peace printed by the Fabian Society, and it is to the former body that the Memorandum on the War Aims of the Labour Party proposes that the colonies of European Powers in tropical Africa should be transferred<sup>2</sup>.

The idea of a League of Nations touches economic phenomena at several points. It has already been shown that it has borrowed something in the way its proposals have been formulated, and perhaps also in some of those proposals themselves, from the devices which are being tried for reducing the consequences of industrial friction. Should such a League be established, it seems possible that it may have effects upon international trade and also upon communication between the various countries, and each of these questions will repay a brief consideration.

As a necessary preliminary to these enquiries, there is something to be said, from the economic point of view, upon the conditions which must precede the formation of a League of

<sup>1</sup> T. E. Cliffe Leslie, *Essays in Political and Moral Philosophy*, 1879, p. 127.

<sup>2</sup> *Times*, December 28, 1917.

Nations. What the economist would expect from it would be a greater degree of security in international affairs. The result of the present war will determine whether any scheme, that is based upon the use of power to maintain peace, is possible. In order to establish security, the proposed League will be required to afford evidence that, in case of need, it will be able to exert decisive pressure upon any great State which has been proved to have endangered the world's peace. The present alliance against the Central Powers is an effective test, which will show, in fact, the strength of the pacific States of the world acting in unison. If through weakness or weariness they failed to secure a decision in favour of the freedom of humanity, the result would be that the claim of the right of the world would not have prevailed against the rebellious might of a group of States. In that event the formation of a League of Nations would be nothing more than a permanent advertisement of a gigantic failure. It would be not only useless but mischievous. It must be proved beyond the possibility of doubt, either now or in the future, that the world will not permit any nation to find in war its most lucrative national industry. Accordingly, the first condition to be established before a League of Nations could be formed will be the defeat of a system of militarism and diplomacy which has been of late years wholly materialistic. If a reign of international freedom and security is to be made possible, the antagonistic principle of the supremacy of force—that principle which sees in this scheme only as Baron von Freitag-Loringhoven puts it “either crass materialism or vague cosmopolitan sentimentalism”—must first be abandoned<sup>1</sup>.

Assuming the attainment of this first condition, a second is no less necessary. The peace which ends the war must be just. The proposed League aims at re-habilitating international law founded upon the moral principles of the civilized world. Therefore it cannot be started upon a peace which ignores these principles. It would be a flagrant contradiction for a League, which was based on wrong, to profess to maintain right. In the words of President Wilson—“There is only one sort of peace that the

<sup>1</sup> Von Freitag-Loringhoven, *Deductions from the World War*, 1918, p. 175.

peoples of America could join in guaranteeing....The terms of the immediate peace agreed upon will determine whether it is a peace for which such a guarantee can be secured. The question upon which the whole future peace and policy of the world depends is this: Is the present a struggle for a just and secure peace<sup>1</sup>?"

It is useless to discuss the economic consequences of the formation of a League of Nations unless upon the assumption that the peace from which it starts, and which it will be its object to maintain, will be such as will contain elements of permanency. Otherwise the economic condition of security would be wanting. What the terms will be which would fulfil that condition are in the main a matter for statesmen. From the economic point of view, any terms which involve the economic subserviency of one nation to another would be objectionable. Such arrangements might well be drafted in a manner that would recognise political independence of a particular nation, but at the same time would consign it to economic serfdom. An enforced tariff may provoke as much unrest as an imposed frontier. Also, compulsory economic dependence is a more subtle evil, than political subserviency. The latter is determinable by the map, and it appeals to all the generous impulses of liberty loving peoples. But the former can be concealed under a fair show of equity, and its detection can be evaded by technicalities which require not only lengthy explanations but also a knowledge of the particular trades that are affected. Hence there grows up an unrest in the country which feels its economic life is restricted. There is a conquest of trade by force of arms as well as a conquest of territory, and the reign of violence is not ended if the captured territory be restored while its trade is made subject to the aims of the conqueror. A peace where this element is prominent may be founded on "no annexations and no indemnities," but the conqueror or the party which is more astute in the diplomacy of trade may secure both. He is able to levy a tribute upon the weaker or less alert nation from which he can annex, piece by piece, a portion of its wealth, and thereby in the course of years gain very much more than

<sup>1</sup> Speech to the Senate, January 22nd, 1917.

would have been possible by an indemnity in the ordinary sense. Accordingly, for a peace to be just the effect of its provisions upon commerce must be considered as well as those that are political.

Not only so, but there is a third condition of a different nature which is no less important. In so far as it is proposed that the League of Nations should effect its purpose by means of conciliation and the investigation of disputes, its success will be governed to a large extent by the adoption of these methods with fruitful results in the chief industrial countries when the war is over. An era of strikes in which conciliation within many countries was an obvious failure or, alternatively, met with very slight success would reduce the chances of the League being established firmly almost to vanishing point. If arbitration, conciliation and mediation are without result in the smaller and easier domestic sphere, it seems idle to expect that they would be tried with much hope in the larger and much more difficult case of international friction. Accordingly, if the war were followed by serious industrial disputes in which conciliation or arbitration failed, the prospects of a League of Nations would be seriously endangered; while, conversely, the avoidance of such disputes, in circumstances of special difficulty, would prepare the way for the League and would improve its prospects very materially.

If, then, it be assumed that a peace has been effected which in its essentials is just and a League of Nations has been founded, the problem arises as to what may be inferred concerning its effects upon commercial policy. There can be no doubt that it will have effects; for one of the methods by which the States, which have joined the League, are intended to put pressure upon members who show a disposition not to abide by the terms of the treaty to which they have agreed or secondly upon a non-member who attacks any signatory State and refuses to submit its case to an appropriate tribunal, is the exertion of economic, as well as military pressure in case of need. Economic action is intended to be graduated. It would begin with the withdrawal of trade privileges conceded by the leagued States; and, if further measures were necessary, it would continue until a complete commercial boycott of the peccant Power was enforced.

In a dispute, which developed comparatively slowly, military action would ensue, if economic measures failed. From this it may be inferred that economic measures for coercion would be used first, and, not improbably, with greatest frequency. It is as if "the invisible hand" of Adam Smith had fallen from the skies to become the hand that wields a policeman's baton. The belief of the Manchester School that commerce promotes peace and amity may have been an illusion, but one will part with it with regret. Ties of trade cannot be quite the same in time of peace, if they become the earliest weapons of the League when a dispute arises—they will be recognised as ties that may become bonds. The least self-sufficing State would be most subject to this type of pressure by the League; and in the early years, when its continuance must be uncertain, it may be anticipated that countries will aim at being self-contained in the essential industries. Further, the contribution, which different States will bring to the total economic pressure which the League can exert, will vary greatly. A country which controls large quantities of food or raw materials would give largely towards making the economic weapon efficient when it was applied against a commercial or manufacturing Power. Also the sacrifice imposed upon members of the League in joining in economic pressure will differ according to circumstances. A nation with a large foreign trade is likely to suffer most. It is true that it may not trade to any great extent with the country which is to be "black-listed," but it is clear that, unless that country on its side has a considerable foreign trade which is important to it, there is little advantage in using the economic power of the League. If that power is worth applying, there must be trade with one or more other countries which the one judged in fault would regret, if suspended. The suspension of exports by these countries to the one upon the League's black list would re-act upon their capacity for taking goods from the first country and so it would participate in the loss quite out of its proportion to the quantity of its trade with that State to which pressure has to be applied. The effect of economic pressure during the war, when it can be estimated accurately, will afford an indication of the results which



might be anticipated from this method of compulsion in the future<sup>1</sup>. But it is to be noticed that the experience gained during hostilities is setting up means by which States can make themselves less subject to this kind of constraint. In self-defence or through force of circumstances many have had to devise means of supplying themselves with commodities which they formerly imported, while the invention of substitutes has made very considerable progress in Germany and to a less degree elsewhere. The war and a League of Nations following the war would both advertise the advantages of economic independence. Here again there is an analogy in business practice. A number of firms might form a working agreement which was not limited to any specific period. Each member of the syndicate would be compelled in its own interests to keep in view the eventuality that the agreement might be dissolved, and therefore, especially in its early stages, they would aim at being prepared to resume independent operations. They would not tie themselves during a temporary combination by such a specialisation as would place them at an avoidable disadvantage in the event of a rupture of the agreement. Any one of these firms would have to face the prospect that events might take such a course that it would be forced to withdraw, and the syndicate would be re-constituted, but against it. To be dependent upon those who would now be its united competitors, to an extent which could be avoided, would be to arrange for its own defeat in advance. When nations are substituted for firms and enemies for competitors, the tendency towards economic independence will be still stronger.

If a League of Nations were established it would be upon its trial for many years. There would be influences in its favour and others against it. The outbreak of hostilities has disappointed all the peace-loving nations, while the long continuance of the war is no less contrary to the expectations of those who anticipated large and quick material gains. The sacrifice of life has focussed the attention of humane people all over the world, with a greater earnestness than ever before, upon devising means by which all possible measures may be taken to free future

<sup>1</sup> Cf. Nicholson, *War Finance*, 1918, pp. 208-215.

generations from so great suffering. The spirit of conciliation is not confined to the belligerents. Neutrals, also, have shared in the catastrophe; and to them, though possibly to a less degree, the removal of future occasions for war will be an object of the greatest moment. In this way throughout the civilized world there will be a genuine desire to avoid war to an extent which has not existed for several generations. After a just peace, this desire will be the most important condition for the effective career of the League. But no peace could settle all the questions at issue. If it establishes the fundamental principles that are involved and secures compromises upon several of the minor difficulties, it will have accomplished much. In a very few years, however, the nations will cease to be satisfied with several of these compromises, while new difficulties will emerge; and friction will result from both. The League will be judged by the success or failure with which it meets these situations. Meanwhile no State which joined the League, could afford to neglect its measures for defence. They may subscribe to the principles of the League, and undertake new obligations as a result, but they cannot do so with more than a hope that peace will be maintained by the efforts of the States which have joined the concordat. The deep impression produced by the horrors of war must, for a long time, cause nations to regard a League for peace as an extra insurance; and at first it is natural that they will continue to rely upon the proved means of defence. No doubt there will be critical occasions when the League itself will seem to be in danger of dissolution. It may even be that, if it is established, there might come a time when it would be broken into two opposing camps and a new war would result. Therefore, in so far as each nation conceives a particular form of industry to be advantageous for its defence or even for resistance against what it might hold to be undue pressure by the League, it will not consider itself justified in taking any steps which would weaken its powers of economic endurance.

In the particular case of Great Britain, the economic weapon of the League will involve a greater departure from the practice before the war than in the case of any other country. On the



assumption that Great Britain would become a member of the League, she would pledge herself to withdraw most favoured nation treatment, and if necessary to join in enforcing a commercial boycott, in the case of any State which incurred the censure of the League. The question whether this country will establish a general tariff or one upon a few industries may still be regarded as open. If either of these courses is adopted, there can be no question that the British tariff would be much lower than that of any other manufacturing country. This would probably hold good if it were compared with the pre-war duties of other States, and it is in the highest degree probable that the great majority of these will increase their Customs duties very largely in order to raise a part of the larger revenue which they will require. Thus there will be a sacrifice which will be considerable for the United Kingdom, but which will be less felt by all the other members of the League. In the first place, this country will be compelled to accept definitely the principle of the control of trade by the State in order to effect political objects, while such control will be exercised, in the case of a decision by the League to use it, at the bidding of an external authority in the formation of whose judgment the British Government has a voice but only as one of many Powers which will be represented. Again, it is probable that the Power, which has a great external trade and which relies to a comparatively small extent upon Customs duties, will suffer more from the use of the economic weapon of the League. On the other hand, such a Power is more interested than any other in maintaining the peace of the world, and if these measures secure it, the gain would tend to outweigh its loss.

The prospects of a League of Nations in its reactions upon the economic position cannot be developed further until some attention has been given to the problem as to whether Germany will become a member or not. It is impossible to determine how States will act in advance. Should Germany decide to stand outside the League, the position of the latter would seem to be liable to great misrepresentation. It would, no doubt, be described as a comprehensive organisation which was designed to

hold a threat of war against Germany and its supporters with the instrument ready to its hand in an economic "war after the war." The right which the League endeavoured to maintain and enforce could be described as a hypocritical disguise for might which was ashamed to avow itself openly. If the present Allies, together with a proportion of neutrals, assented to the principles of the League, it would control both the bulk of the world's raw materials as well as the main routes for transporting them. The use to which this overwhelming economic power was put would determine the reputation which the League would win for itself. A Germany outside it would not affect its economic power to a sufficient extent to render it ineffective, but it would make the early years more difficult. This, however, is only one alternative. If the war ends in an indecisive and probably temporary peace, it would be waste of time and energy to attempt to establish a League of Nations. There would be no respect for international arrangements of any kind and material force would remain dominant, as was said long ago, "relying upon the fury of contention<sup>1</sup>." But when the war ends in the establishment of the sanctity of a nation's plighted word, and in the recognition of the elementary moralities in the affairs of nations, the new Germany which accepts these principles may be expected to be not only ready but willing to enter a League of Nations, if not at the beginning after a brief delay. Then it will rest with the League to induce, and if need be to compel observance, of the fundamental principles which have been bought at a very great price. This is the "great consummation" which Mr Wilson had in view when he spoke of "the common force which shall safeguard right as the first and most fundamental interest of all peoples and all governments, when coercion shall be summoned not to the service of political ambition or selfish hostility, but to the service of a common order, a common justice and a common peace."

The proposed League could be constituted so as to offer some inducements to nations to become members, not only from

<sup>1</sup> νελκεῖ μαινομένῳ πλόννος. Empedocles, *De Natura* (ed. Karsten), Carm. 1. 6.

political motives but also upon economic grounds. While each signatory Power would remain altogether free to maintain its own commerce and also to protect it, if it thought that course advisable, it would be contrary to the permanence and success of the League if the States, belonging to it, should take measures to discriminate against each other's trade. Common political action is unlikely to succeed if accompanied by economic hostility, even though veiled. Representatives of the leagued nations could not meet under the best conditions, in order to maintain peace, if some of them were involved in tariff wars at the time.

Political and economic conditions interact to a larger extent than has been recognised in this country hitherto. Where relations between two countries are strained, neither can be expected to avoid injuring the trade of the other, when this is possible. Similarly, where there are antagonistic commercial interests, there is often discrimination and this, if continued, will arouse or increase political tension. Economic pressure to be effective must be vested in the League while the States, which become members, would be almost compelled, logically, to abandon the use of this instrument in the form of discrimination as against each other. Conversely, they would retain full freedom of fiscal action against non-signatory Powers. As far as the result can be forecasted, the tendency would be for tariffs of most of the members of the League to be relatively high as against States outside it, and this would be an inducement for the latter to come within the League. But if this estimate of the future is correct, it leads to an important consequence. As tariffs of the States of the League rise against nations, who are not members, the latter will be compelled to trade more with each other, and, to that extent, the economic weapon of the League becomes less effective against a non-signatory State, but probably somewhat more effective against a member of the League to whom pressure must be applied.

The idea of a self-denying ordinance, by which the signatory Powers would refrain from imposing discriminating duties upon each other's trade involves some difficulties. The perennial

question of trade between colonies and the mother country arises. It may reasonably be held that any preference or privilege given by the parent country to the colony or secured in the colony for the home country should not be construed as a discrimination against the other nations of the League. If a customs union were instituted between a European country and its colonies, by the former increasing its duties against all outsiders, the question of discrimination could not be raised. The problem here is economic, but it soon acquires importance from the political aspect. The importance of colonies consists, from one point of view, in the raw materials which they provide, as well as the market which they afford to the manufactures of the mother country. Freedom of access to the raw materials of all colonies, or at least all tropical colonies, by members of the League has been suggested<sup>1</sup>, and there is little doubt that this method would remove one powerful economic motive resulting in the "scramble for colonies." As applied to tropical dependencies, it would be, in fact, an economic internationalisation of these. This plan would meet a great part of the difficulty, but still a part of it would remain. A case is possible in which a country owns a dependency which is capable of producing a raw material that many countries desire. By a careful integration of the industry from the production of the raw material up to the completed manufacture, a monopolisation of the commodity could be effected. It is true that the part of the industry which obtained the raw material would lose by restricting the sale of it. Tempting offers from foreign merchants would be refused. But from the point of view of the trade as a whole, that loss would be more than recovered by the monopoly accruing from the sale of the finished goods. Such a policy might not be to the national interest in the long run, but it could be supported by exceedingly plausible arguments. While other nations feel the economic inconvenience, the political remedy is not easy to discover. If the process of manufacture, which has been suggested, had grown up altogether by private enterprise, there is no discrimination against foreign nations by the Government of the State.

<sup>1</sup> H. N. Brailsford, *A League of Nations*, 1917, pp. 230, 264, 283-6.

On the other hand, to suggest that the League of Nations ought to interfere in the internal economic organisation of one country, in the interests of other countries, would be to prejudice its chances of success at the outset, for it would incur the risk of acquiring the character of a mere international busy-body. An ultimate solution is possible upon the condition that the League became firmly established and gradually secured the respect and confidence of the greater part of the world. In that case, when the time was ripe, it might perform a useful function in considering the question of monopolies in so far as they affect international relations; and, as a result of such consideration, further agreements might be effected which would regulate them.

The more the proposed League could facilitate commerce, the greater would be the advantage of membership; and, as a consequence, the economic pressure which could be exerted upon a member would be more powerful and effective. Small civilized countries would feel that pressure most. A large and powerful State would probably not wait for economic measures to be taken by the League, but would attack its immediate enemy at once, in the hope that victory could be secured before the slow moving forces of the League could be brought against it with effect. Besides, as has already been shown, most countries of this class would be able to build up means of supplying their essential needs either by development of existing natural resources or through the improvement of substitutes. There is also the risk of extensive smuggling to be taken into account when the League proclaims an embargo upon commerce between all signatory States and a country which has infringed the code of the League. It can scarcely be expected that all these countries would exercise the same painstaking supervision of their exports that would be needed in order to attain the maximum degree of efficiency. The danger of indirect trade through small countries, which were not members of the League, would be considerable; while a universal "rationing" of these by all signatory States appears to be almost impracticable.

Weighing all the diverse considerations, it may be concluded



that economic influences could be used in such manner as to contribute materially to the cohesion and stability of the proposed League. At first the unifying influence would be dormant. The League would be an experiment; and, however much some of the members might hope from it, no State could place any great reliance upon it at this stage. A high degree of faith in the future, and even in peace, would not necessarily involve unlimited trust in the League. Later, if it survived the first critical years and nations became accustomed to co-operate with, rather than to frustrate each other, a tendency would show itself towards reciprocal arrangements in trade. When this point would be reached the force of economic pressure, as applied to offending States, might be expected to be rather greater in the case of a signatory nation, than in that of one similarly situated which was not a member. Further, if an early dissolution of the League could be avoided and if it is to be anything more than a species of international "Advisory Council," the commercial privileges of membership would tend to attract within its orbit some States, which at first stood outside. As against this, a certain degree of centrifugal force may be anticipated which would work towards detaching others which are the more progressive and enterprising. What often happens in the case of small organisations would be likely to show itself upon the larger scale with greater intensity—namely that membership imposes limitation and restraint upon the abilities of the most active and far-seeing members. As far as the League will affect progress, it would establish a rate which was neither the fastest nor the slowest, but a species of intermediate pace. At the same time if all the great commercial nations join it, though they would lose something, the tendency would be rather more to a levelling up than to a levelling down. Perhaps the ultimate loss would not be very great, for in the past some small nations, through their different ideals of national life, have shown themselves to be remarkably obstructive to the ideas of Western industry, both to their own loss and that of the industrial nations. When such small States belonged to the League they would have an opportunity of coming into close contact with the new problems of international

relations in commerce, and it might well be that the League could take steps to protect them from being exploited.

These inferences lead on to another. The League cannot develop unless numerous and somewhat detailed agreements are made between the members. Therefore its foundation will be the restoration of faith in the pledges of nations. After the experience of nearly four years, the re-building of confidence in international agreements must be slow. It is idle to wrap up in sugared phrases the fundamental condition that, though the League may proclaim its reliance upon right, this will be almost useless unless it is able to defend the arrangements which are believed to approximate justice as nearly as possible. An active policy of this kind, which would be supported loyally by all the members, if necessary, up to the limits of their power, would be a strong influence in guaranteeing peace. Unfortunately it may not be more than a conditional guarantee, for it might happen in the changes which time brings that two groups of States, within the League itself, which were approximately equal in resources would interpret right in some crucial case in contradictory senses. In that case, if most of the Powers which formed the League were involved in the dispute, it would be impossible to constitute a Council to which the dispute could be referred with a prospect of obtaining a decision which would command even a moderate amount of support. There would be no effective mediation possible, and it seems as if the dissolution of the League would follow with a world war as the consequence. Under not unfavourable circumstances there appears to be another alternative. Provided such a test of the League did not come in the first years of its existence, it would seem possible that it could develop some form of organisation which would meet the difficulty. Failing the discovery of a better method, the period for deliberation which some suggestions for constituting the League recommend, might be extended for a longer period with the consent of both parties: and, after the expiration of this further interval, the points at issue might be re-submitted to the Council. In the state of feeling which will follow the war the prolonged interval for reflection and enquiry would doubtless



be used in the preparation of armaments, but this result need not necessarily follow if the League were well established. People would remember instances of disputes, which at first seemed almost insoluble, where a peaceable and equitable solution was attained by the intervention of the Council. Such experiences would give prestige to the judicial processes of the League, and it might well be that reflection and enquiry over a number of years, joined with the progress of events, would eventually point the way to a solution.

In the foregoing account of the possibilities of the League, attention has been directed as far as possible to its economic effects. Any complete abstraction of these from the political consequences would be unreal and illusory. The two constantly interact. It seems to me that the attitude of supporters of the League inclines somewhat too much towards over emphasizing the power of economic compulsion. While diplomatists and statesmen, who advocate the scheme, are cautious as to the political side, they incline to be more optimistic as to the economic one. The economist would be disposed to lay stress on his hopes from the political rather than the commercial side. Possibly, where the difficulties are most before the mind, there is less confidence. An armed peace has been followed by a devastating war, and it is only ordinary prudence to strive earnestly to make peace easy and war difficult. On the assumption of a just peace, it will remain to make it as lasting as possible. The development of commerce and industry will crave not only security but a higher degree of it than has been experienced during the last thirty years. The project of a League of Nations is a scheme which may be, on the whole, deserving of a fair trial. The end of the war is the time when it could be established with the best prospects. In the words of Lord Bryce "if this opportunity be lost, another such opportunity may never re-appear." No doubt there are many obstacles and hindrances, political, constitutional, military and even economic. But if no League of Nations is established, against these must be balanced the almost certain return of tension and insecurity not many years after peace has been signed. The prospect offers sufficient hope to point towards

giving the scheme a trial, but not sufficient hope to rely upon it until it has actually justified itself by a protracted test. Thus the most that can be said of the scheme at present is that it is a favourable uncertainty, against which is to be set an unfavourable certainty. In such circumstances we should be wise, upon the whole, in accepting Tennyson's maxim, "Cleave ever to the sunnier side of doubt."

THE FINANCIAL BURDEN OF TODAY  
AND OF TOMORROW

Boni pastoris est tondere pecus non deglubere.

TIBERIUS CAESAR, quoted by Suetonius.

## THE FINANCIAL BURDEN OF TODAY AND OF TOMORROW

IN Burke's speech upon conciliation with America, he paused at one point in order to review the effect of the crisis (which then existed) upon the opinions that had been commonly held upon important questions. He said, "It is good for us to be here. We stand where we have an immense view of what is, and what is past. Clouds, indeed, and darkness rest upon the future<sup>1</sup>." Another orator, Louis Kossuth, might almost be said to have corrected Burke's metaphor—"As the sun looms through the mist before it rises, so the future is seen in the events of the present day"—a sun that some of us think will rise in a fair dawn, but which others regard as angry and presaging storm and tempest.

"The immense view" includes much which the exigencies of the time force upon our attention and enable us to see with a clearness that was formerly impossible. Economic writers of the past sometimes considered the best course of action in the circumstances which they anticipated would arise in time of war and stated the conclusions to which their enquiries led them. But those results were always based upon either general considerations or the experience of past wars which were applied to what was for them a future war,—and, as far as British writers were concerned, to hypothetical wars which it was always hoped would not be possible. For us, unfortunately, the hypothetical war has become a sad actuality, and it will not be out of place to endeavour to test the theories of the past by applying them to the needs of the present which they were, in part at least, designed to meet. The particular instance in point is the discussion of the best method of raising funds for the prosecution of war—a question which is not only of interest during the conduct of hostilities,

<sup>1</sup> E. Burke, *Works*, 1793, II. p. 33.

but which will react upon the rate of recovery in the early years of peace, and which may influence, and even mould, many social changes in that period. Both national credit and mercantile credit may be affected materially by the methods adopted and their consequences, while serious errors may produce grave commercial and industrial disorders.

There are few economic questions upon which opinion has been so divided and for so long a time. Broadly speaking, there were two dominant and contradictory views. The earlier, which may be named the British theory, was that all war expenditure should be obtained from taxes levied while the war was in progress. To this was opposed the German theory, that all war expenditure ought to be met by loans. For brevity the first may be called the "all tax view," and the second the "all loan view." These extreme opinions were not held generally in either country in their original form at the outbreak of the present war. Their clear cut precision has been very considerably modified; but, as far as it is possible to generalise, in this country and in the United States taxation was given a larger place in a war economy than was the case in Germany.

Of these two theories the British "all tax" theory was the earlier, and therefore it may be described first. From the time of Petty to that of John Stuart Mill this doctrine was advocated with emphasis by many of the leading writers. Petty, writing in 1665, based his calculations for the distribution of the taxation to pay the expenses of the war with the Dutch, then in progress, upon the assumption that the whole amount would be raised by this method<sup>1</sup>. Davenant, writing thirty years later, urged that it would be well, "if we could bring it about," to meet the year's expense with revenue obtained within the year, and he considered that this might be accomplished by Excise duties, if the raising of them "might not hazard the Constitution<sup>2</sup>." Archibald Hutcheson, the acute critic of the period of

<sup>1</sup> Petty, "Verbum Sapienti" in *Works*, edited by Hull, p. 103.

<sup>2</sup> Davenant, "Essay upon Ways and Means of supplying the War," 1695, in *Works*, I. p. 80. Davenant, however, was far from consistent. In his "Discourses on the Public Revenues and on Trade," 1698, he wrote, "Nations that have a war too big to be managed by any income to be raised within the

inflation during the South Sea Bubble epoch, declared that "until our debts are discharged we can scarcely be said to be a people. I'm sure, till then, we are a people in a state of the utmost insecurity<sup>1</sup>." Similarly Hume contended that "either the nation must destroy public credit, or public credit will destroy the nation<sup>2</sup>." These statements were negative, as regards public loans, rather than positive in advocating the raising of the necessary expenses immediately by taxation. Decker and Fauquier emphasized the latter conclusion, the latter proclaiming explicitly that all funds required by the Government for whatever purpose, even for an expensive war, should be raised by taxation "within the year," and he believed everyone would recognise this method as the most advantageous, and consequently the most eligible for himself, his children and his country. "And though it should be attended with some little present inconvenience, I am sure that man can have little pretence to any feelings of public spirit, who would not submit to a short-lived tax upon his extravagance to procure such certain and lasting advantages<sup>3</sup>," in the avoidance of an addition to the national debt.

The raising of all supplies for public expenditure within the year by means of taxation became a maxim in public finance during the succeeding century. Adam Smith, Ricardo, Chalmers, M'Culloch and J. S. Mill all assented to it, and some of them supported it vehemently. A passage of Chalmers perhaps states the position with the greatest brevity and point. "The difference," he writes, "between the system of raising money by loans and that of providing for all the expenses by taxation is that, while in both ways the same pressure is made *at the time* on the comfort of families, in the former way there is the formation and

year, could not avoid proceeding in this manner [i.e., by borrowing], and must be contented for a while, to pay taxes to one another, which may be done without great mischief to the subjects, provided a due moderation be observed; for in this matter there is a certain limit, beyond which there is no passing in any wisdom." *Works*, I. p. 153.

<sup>1</sup> *Some Paragraphs on Mr Hutcheson's Treatise on the South Sea Subject*, 1723, p. 10.

<sup>2</sup> "Of Public Credit" (1752), *Works*, 1779, I. p. 381.

<sup>3</sup> Francis Fauquier, *An Essay on Ways and Means* (1756), Baltimore, 1915, pp. 28, 29.



growth of a great national mortgage which remains to oppress and enfeeble the country. In either way, the State may obtain the same supplies; but, in the former way it obtains them at a double expense to the nation. The present burden is just as heavy in the one way as in the other; over and above which there is the prospective burden equal to the present which the system of borrowing leaves behind it<sup>1</sup>." While Ricardo agreed with the practical conclusion which Chalmers advocated<sup>2</sup>, he was too acute to adopt the catchword of "the double expense" of loans to the nation. He expressly stated that in point of economy there is no real difference between the method of taxes and that of loans. He advocated the raising of all supplies within the year upon other grounds, such as the bringing home to the people the cost of the war, and thereby shortening the continuance of hostilities<sup>3</sup>.

The discussion of the principles involved in these contentions may be postponed until the arguments for the converse view have been stated; but, in the meantime, it is worthy of note that the great majority of those who, after the middle of the eighteenth century, urged the raising of all supplies within the year wrote during the peace following a war in which the debt had been increased. The generation which is involved in a war usually forms an estimate of the benefit of its results to posterity, which posterity not infrequently fails to indorse, thereby justifying the satire of Swift, who said "it is pleasant to observe how free the present age is in laying taxes on the next: future ages shall talk of this: this age shall be famous to all posterity<sup>4</sup>." The writings of the posterity of Swift's time during the next three generations show that his anticipation of the volubility of those, who paid the taxes which furnished interest upon previous loans, was realised to the full. And this part of economic doctrine in the eighteenth and the early part of the nineteenth centuries,

<sup>1</sup> T. Chalmers, *Political Economy*, 1832, pp. 494, 495.

<sup>2</sup> Professor Edgeworth mentions some of the objections to Chalmers' view, remarking wittily that "his view of a public debt as a double burden is twice removed from the view which I have entertained." *The Cost of War*, p. 46.

<sup>3</sup> Ricardo, "Essay on the Funding System" (1820), in *Works*, 1852, p. 538.

<sup>4</sup> Swift, "Thoughts on Various Subjects," in *Works*, 1762, I. p. 291.

affords an instance of one type of future satisfaction which, unlike most, is not undervalued<sup>1</sup>, namely that which one generation estimates its successors will procure from successful national defence!

It is not to be thought that during the eighteenth and the first half of the nineteenth century opinion in this country was wholly agreed upon the advisability of raising all supplies within the year. Occasionally there were a few who advocated reliance upon credit to a greater or less degree. Berkeley considered that a nation's credit was proportionate to what he termed its "momentum," that is the united action of a whole people, and that such credit was the principal advantage England had over the other countries of Europe<sup>2</sup>. Sir James Steuart contended that when a great expenditure has to be met, unless reliance is placed upon "a systematic scheme of credit, the infallible consequence would be that the taxes formerly imposed cannot be paid, much less augmented<sup>3</sup>." A less known writer, John M'Arthur, after an examination of the debt during the eighteenth century, came to the conclusion that both the revenue and the wealth of the country had increased more than in proportion, and that in that period "the public credit of Great Britain had risen to a pitch of grandeur and stability unknown to other nations<sup>4</sup>."

The Crimean War represented a turning point in the method of providing funds. Though Gladstone argued in favour of the traditional "all tax" policy, and while, as Leroy Beaulieu has shown<sup>5</sup>, both in this and the previous great war Great Britain was exceptionally favourably situated for raising a large part of the cost by taxation, the proportion of the outlay obtained by taxation fell from 47<sup>6</sup> per cent. in the French War to 43 per cent

<sup>1</sup> H. H. Gossen, *Gesetze des mensch. Verkehrs*, 1889, p. 3; W. S. Jevons, *Political Economy*, 1911, p. 35.

<sup>2</sup> Berkeley, *Querist*, Nos. 233-235, 582, 583.

<sup>3</sup> Steuart, *Inquiry into the Principles of Political Economy*, 1767, II. pp. 471, 472.

<sup>4</sup> M'Arthur, *Financial and Political Facts*, 1801, pp. 163, 171.

<sup>5</sup> Leroy Beaulieu, *Traité de la Science des Finances*, 1891, II. p. 251.

<sup>6</sup> Professor Bastable shows that the amount of war expenditure during the Napoleonic Wars which was met from taxation was actually less than 27 per cent. The total war expenditure was 830 million pounds. Of this 600

in that of the Crimea. Between the Crimean War and that now being waged there has been no opportunity of testing the general trend of opinion upon the question of the financing war expenditure upon a large scale, but the magnitude of the change since Adam Smith and Ricardo may be seen by the growth of local debt in recent years. Expenditure, whether by the central or local authorities, is essentially one from the point of view of public finance, and so likewise are the loans by these two classes of borrowers acting on behalf of the State<sup>1</sup>. The increase in the loans of local authorities during the last fifty years is a matter of common knowledge<sup>2</sup>, and recent writers have ceased to question the necessity of such borrowings, provided due safeguards are observed. It is clear that this represents a striking departure from the teaching of Adam Smith and Ricardo. While developments in the production of many things, which make for improvements of social life, have caused these to increase in cost, and therefore made it difficult, if not impossible, to provide them out of income levied within the year in which the expense is incurred, the principle governing the acceptance of the practice of loans is not wholly clear. It is not based on borrowing for the establishment of so-called reproductive enterprises, since, historically, local loans were first adopted for unproductive undertakings<sup>3</sup> which were judged necessary for the health or welfare of a particular community. Thus it cannot be maintained that, in all cases, these loans are of such a nature as to yield a revenue which would provide the necessary interest, nor can it be shown that there is invariably an asset which is vested in the local authority which is equal in value to the amount of the loan outstanding. For instance the money value of the clearing of congested areas, of street widening and other improvements (however admirable these may be for other reasons) is

million pounds was borrowed and 230 millions raised by taxation—*Credit, Industry and the War*, 1915, p. 242. The percentage is stated at a higher rate in a calculation of Mr W. Schooling printed in *The Economist*, March 23, 1918.

<sup>1</sup> Bastable, *Public Finance*, 1903, p. 722.

<sup>2</sup> The outstanding loans of local authorities, between 1875 and 1913, increased by about 600 per cent.

<sup>3</sup> *Economic Journal*, xiv. p. 49.

often highly problematical. Accordingly, it appears that the ultimate distinction which was accepted in the first years of the present century was that borrowing by a local authority might be justified, if it was considered that the purpose, for which the loan was required, was one which advanced the welfare of the district and which, at the same time, involved a large capital outlay<sup>1</sup>.

On the outbreak of the South African War the effect of the change of opinion showed itself as having extended from local to national finance. Giffen did not criticise the amount raised by borrowing, though he took exception to the form of the loans<sup>2</sup>. Professor Bastable considered that in the later stages of the war weakness was shown in not watching the increase of debt, and, after the war, in not making sufficient provision for redemption of war loans<sup>3</sup>. At the same time, the break with the early writers is marked, when, in discussing the Budget of 1900, in relation to the proposal that the whole cost of the war should be met by taxation, he approved of the policy of borrowing a part of the war expenditure, remarking that "the proposals of the Chancellor of the Exchequer are not heroic, but heroic finance is both troublesome and expensive<sup>4</sup>." Professor Nicholson took the view that in war "borrowing is the only resource." A just war is in the permanent interests of the State, and therefore a part of the cost should be borne by posterity. Even in the interests of future generations the whole cost should not be raised by immediate taxation, because very high taxation injures the productive power of the country, and thus it would injure posterity more than the burden of the loan. Indeed, if an effort was made to carry out the counsels of the early economists which resulted in taxation becoming excessive, the results would be unfortunate. For it would become unproductive, and, if the war were to be continued, it would be necessary to borrow, probably upon less advantageous terms than would have been obtainable otherwise.

<sup>1</sup> Nicholson, *Public Finance*, 1906, p. 16.

<sup>2</sup> Giffen, *Works*, II. pp. 218, 219.

<sup>3</sup> *Economic Journal*, XII. p. 261; *Public Finance*, 1903, p. 641.

<sup>4</sup> Bastable, "Note on the Budget of 1900," in *Economic Journal*, X. p. 201.

Thus the final consequence, as regards future generations, would be that they would be burdened doubly, first by contracted production (which might have been avoided) and secondly by the loan itself<sup>1</sup>.

It will be noticed that there has been a gradual change in British opinion. The earlier "all tax view" had been abandoned before the present war by most of the leading financial writers; but, at the same time, there remained an almost universal advocacy of increasing taxes in time of war. While this was the accepted opinion in this country, it is far from being received with general favour elsewhere. And for purposes of contrast, the views of German economists may be examined next. If, at one period, British thinkers usually advocated an "all tax" policy for war costs, there was a strongly marked German tendency towards an "all loan" policy. Traces of this view may be found in Justi, whose chief work was issued in 1755. He was greatly impressed with the extreme cost of war, which required rather the sacrifice of unmeasured sums of money than of blood<sup>2</sup>. If the amount to be raised is not very great and is not required at once, while if on the other hand the expense is expected to be temporary, then it is best to rely upon taxation. But if these conditions are not fulfilled, then loans are necessary. In view of this need and the circumstances of the time, Justi directed much attention to the development of German credit<sup>3</sup>. Temporarily Adam Smith exerted some influence upon German writers of his own generation<sup>4</sup>, but the view of Justi was reasserted after the Napoleonic Wars by von Jacob<sup>5</sup> and Nebenius<sup>6</sup>. Rau was even more definite in asserting that, in the event of a sudden emergency such as war, loans were not only necessary but even beneficent, thereby reviving the view of a seventeenth century English writer who entitles his tract—*Taxes No Charge*<sup>7</sup>.

<sup>1</sup> Nicholson, *Principles*, III. 408, 409; *War Finance*, pp. 432, 433.

<sup>2</sup> J. H. G. von Justi, *Politische und Finanzschriften*, 1761, p. 175.

<sup>3</sup> *Ibid.* *Staatswirthschaft*, Th. II. pp. 435, 587–608.

<sup>4</sup> E.g., Schmalz, who spoke of State debts as a great evil, *Handbuch der Staatswirthschaft*, 1808, §§ 419–423.

<sup>5</sup> L. H. von Jacob, *Die Staatswirthschaft*, 1821, § 728.

<sup>6</sup> F. Nebenius, *Der öffentliche Credit*, 1820, p. 429.

<sup>7</sup> *State Tracts of William III*, 1689, II. p. 116.



A more definite position was taken by Dietzel, who distinguished between ordinary and extraordinary expenditure, the latter being that which is non-recurrent. Taxes suffice for the ordinary outlay, whereas the extraordinary (which includes all expenditure on the maintenance and extension of the national establishment) ought to be met by loans as a matter of course<sup>1</sup>. Stein, like Dietzel, endeavoured to incorporate the defence of loans into a system of national finance. Borrowing for extraordinary expenditure is a necessary and organic part of the life of a State forming part of the higher statesmanship. The State, without a debt, either does too little for its future or rests too much upon its past. In a sense an increase of debt is an addition to the national capital for, according to Stein, it provides for its interest and redemption by reason of the useful purpose which it serves. In some cases the realisation of the desired end is long deferred, and the existence of a debt for that special expenditure enables the necessary taxation (which is required for its interest and redemption) to be imposed with equity upon those who benefit by the expenditure<sup>2</sup>. It was not unnatural that the financial result of the Franco-Prussian War seemed to give the support of actual experience to the theories of Dietzel, and the possibility of an indemnity finds a significant place in subsequent German financial literature. Cohn, who did not agree with all the theoretical implications of this view, nevertheless accepts its practical maxims, mentioning the possible favourable outcome of war in the form of an indemnity<sup>3</sup>. Thus, to adopt an expression of Junius, "what was yesterday a fact, to-day is doctrine." Similarly, Roscher<sup>4</sup> and Wagner<sup>5</sup> both endeavoured to remove some of the more palpable exaggerations of Dietzel and Stein, while they accepted the need of loans to meet extraordinary expenses, subject to certain limitations. The latter, for instance, held that taxation and borrowing are two forms of the same operation, the consequences of which are

<sup>1</sup> C. Dietzel, *System der Staatsanleihen*, p. 182.

<sup>2</sup> L. von Stein, *Lehrbuch der Finanzwissenschaft*, 1871, pp. 660-672.

<sup>3</sup> G. Cohn, *Science of Finance*, Trans. Chicago, 1895, p. 721

<sup>4</sup> W. Roscher, *System der Finanzwissenschaft*, 1886, p. 523.

<sup>5</sup> A. Wagner, *Finanzwissenschaft*, 1877, pp. 118, 123.

specifically alike and gradually become differentiated. The tendency is to relegate extraordinary outlay to borrowing, but there are theoretical limits which are determined, in the main, by the degree to which, in any special case, taxation would involve less hardship than loans.

It will appear then that the result of the progress of opinion has been that, on the one side, German writers have modified their nineteenth century "all loan" method of raising the funds necessary for a great war, but to a trifling extent; while, on the other hand, the early British "all tax" system has been greatly changed. The position before the war was that German economists relied mainly upon borrowing for war finance, while in this country, so far as the question was discussed, it was held that a part of the outlay should be obtained from taxation<sup>1</sup>. How far each country followed the views of its financial writers, how far the methods actually adopted have been successful are being shown in the finance of the war, but the ultimate result will only be revealed during the generation which follows the war, here, once more, the days to come will prove the most reliable witnesses<sup>2</sup>.

There have been other special studies upon this topic made elsewhere than in Great Britain and Germany. Professor Adams, in discussing the financial management of war in 1888, shows that it would have been impossible to have obtained the amount required in the first year of the American Civil War by means of taxation, without precipitating a crisis in the Northern States which would have prevented the securing of adequate funds during the remainder of the contest. He recommends borrowing the whole of the first year's special war outlay. Then, during the course of that year, new taxation should be imposed, partly by increasing existing duties and partly by

<sup>1</sup> It is interesting (and highly significant as regards responsibility for the origin of the war) to observe the detailed examination of war finance by German writers during the last fifty years, as compared with the cursory allusions to this subject by British authors, cf. W. R. Scott, "Economics of Peace in Time of War," in *Credit, Industry and the War*, 1915, p. 2.

<sup>2</sup> ἀμέραι δ' ἐπίλοιποι  
μάρτυρες σοφώτατοι. Pindar, *Olympian Odes*, 1. 33.



adding new ones. From these a small revenue will be received in the second year, but the remainder for that year must be borrowed. Thereafter, during each year the war continues, the proportion of income from taxation will increase till at the end, if the struggle be long continued, the proportion obtained by taxation may exceed that from loans<sup>1</sup>. As regards this proportion, it is probable that the course suggested was influenced partly by the experience, and partly by the recognised mistakes of the finance of the Civil War. The late Professor Leroy-Beaulieu agrees in part with Adams. In normal times taxes are to be preferred to loans, but in critical circumstances the necessary amount of taxation would produce a terrible crisis and almost paralyse the life of the country. Therefore recourse must be made to loans, though, at the same time, taxation should be imposed, where it is possible, in order to prevent the debt from becoming too great<sup>2</sup>. Professor Pareto, in reviewing the financial policy of the belligerents in 1916, regarded the increase in the debts of some of them with considerable anxiety, and he evidently concluded that, in some cases, repudiation was a possibility which might have to be considered<sup>3</sup>. The whole question has been studied afresh by Professor Einaudi, and he comes to the final conclusion that a war cannot be financed either by new taxes or additions to old ones. Thus borrowing must be added to the resources provided by taxation. The proportion between the two will depend upon the wealth of the country involved in war and the level of pre-war taxation in relation to its resources. When these facts are known, the respective percentages of war expenditure procured by taxes and loans will be determined on the one side by the limit of not pushing taxes to an extent which would provoke political reaction and on the other by taking care that the loan policy will be accommodated to the economic needs of the country<sup>4</sup>.

It will be observed that none of the leading authorities in any

<sup>1</sup> H. C. Adams, *Public Debts*, 1888, pp. 109, 140-142.

<sup>2</sup> P. Leroy-Beaulieu, *Traité de la Science des Finances*, II. pp. 244-280.

<sup>3</sup> V. Pareto, "I Debiti pubblici dopo la Guerra," in *Riv. Di Scienza Bancaria*, Feb. 1916.

<sup>4</sup> L. Einaudi, *La Finanza della Guerra*, 1914, pp. 22-53.

country, before the war<sup>1</sup>, adopted the "all tax" doctrine of the eighteenth century British writers, while many approximate to a greater or less degree to the opinion which, on the whole, prevailed in this country before the war. On the other hand, in this as in a vast number of other cases, the intellectual isolation of Germany is marked—very few financial writers in other European countries having accepted the "all loan" dogma.

Hostilities have created an opportunity and a need for the testing of the doctrines held before the war in the light of current financial demands. Moreover the sad events of war have compelled us to make precise much that was left indefinite in the views upon this subject which were held here and in France, Italy and America—a vagueness of statement undoubtedly due to the essentially pacific disposition of these nations.

When one reads carefully those writers who advocated the "all tax" system, some impression begins to emerge as to the amount of war expenditure which they had in view. Adam Smith seems to have contemplated that, in war, the additional expenditure would bring the whole outlay up to three or four times the normal. This was the amount which he recommended should be paid by taxation<sup>2</sup>. But that proportion has been secured, approximately, in the financial year 1917-18 and is likely to be exceeded in 1918-19; so that, although we are far from conforming to Adam Smith's principle as he formulated it, we are curiously near the actual amount which he thought should be raised by taxes. In other words, if the proportion between war expenditure and the normal expenditure had continued the

<sup>1</sup> Soon after the declaration of war by the United States 275 American Economists framed a memorial urging that war expenditure should be met mainly by taxation. This recommendation was based in part upon the alleged tendency of borrowing to cause inflation of general prices and in part upon social and ethical considerations. Professor E. R. Seligman points out in reply that the memorial exaggerates the degree of inflation caused by loans. Much depends upon the conditions on which the loans are contracted. He recommends raising enough by taxes to pay interest on the debt, and, in addition, its speedy amortization. But he adds that the Revenue Authorities should be careful to avoid stifling enterprise and causing intolerable discontent. E. R. Seligman and R. M. Haig, *How to Finance the War*, 1917, pp. 1-14.

<sup>2</sup> Adam Smith, *Wealth of Nations*, 1904, II. p. 395.

same as that which he had in view, we should have raised the amount which he considered necessary<sup>1</sup>.

This lengthy review of opinion in the past has seemed advisable in order to clear the ground for an investigation of some of the chief issues which are involved. Some of the current thought upon this topic is in danger of incurring that fruitless labour so well described by Shakespeare—

If there be nothing new, but that which is  
Hath been before, how are our brains beguiled,  
Which labouring for invention, bear amiss  
The second burden of a former child<sup>2</sup>!

It remains, then, to discover how far the financial enquiries of the present day are adapted to existing conditions and whether the children of their "invention" are in fact fitted to survive in the world into which they are born. The attitude of mind with which the present must approach the theories of the past has been well expressed in that old romance known as the *Argenis* of John Barclay, which Coleridge, Cowper and Southey esteemed so highly. "Our ancestors," Barclay said, "did provide for the affairs of those times, according to the disposition of them. To us, it will be sometimes for the best, as the occasions doe differ which we are encountered withal to dissent from their opinion and vary from their courses. And I should think it an unreverent pride in everything to neglect the wisdom of our ancestors, so I should account it an absurd kinde of respectiveness, which should perpetually bind us to the observation of their courses<sup>3</sup>."

I may start by a truism. The State requires goods and services which will be immediately available here and now in order that it may wage war—"an army cannot live on bread to be delivered,

<sup>1</sup> In the French wars the largest increase in the revenue from taxation was in 1815. The amount then obtained was three and three quarter times that of 1792. This proportion is curiously close to that obtaining between the revenue from taxation and State services in 1913-14 and 1917-18, respectively. All the same full weight must be given to the larger proportionate resources of the country at the later period.

<sup>2</sup> Shakespeare, *Sonnets*, LIX.

<sup>3</sup> J. Barclay, *Argenis*, 1621, lib. III. The translation in the text is that of Sir Robert Le Grys of 1629.

at the option of the baker, between twenty and forty years from the date of the contract<sup>1</sup>." The question then is should the Government take the necessary goods and services without compensation (the "all tax" method) or with compensation (the "all loan" method) or partly in one way and partly by the other. The answer cannot be given in any absolute form, for it depends upon a number of diverse and exceedingly complex considerations. Modern warfare requires the exertion of a nation's power, and the words of Peel come back to us, after the lapse of more than three quarters of a century with added force and a new meaning. "The first step towards safety," he said, "is a knowledge of the real source of our strength, a just confidence in it, and a firm resolution to exert it<sup>2</sup>." Clearly, if a nation at war determines not to borrow, it may run the risk of depriving itself of the benefit obtainable from the goods, suitable for carrying on war, which it might secure from other nations, either neutrals or allies. Even some of the most thorough-going advocates of the revival of the "all tax" policy appear disposed to permit foreign loans as an exception<sup>3</sup>. From the point of view of the aggregate goods obtainable, there can be no question that a larger amount, under existing conditions, can be secured by the State by a well-judged system of borrowing than if it relies upon taxation only<sup>4</sup>, even if it be assumed that the latter method would be workable. The reason for this will be apparent when it is remembered that no system of taxation, however well devised, can secure all the available resources of all the people, still less is taxation an incentive to eliciting their maximum effort. Thus, at some stage, the aid of credit must be invoked, if a nation is to mobilise all its economic resources. "If one combatant will strain his resources to the utmost, and the other is obliged to act similarly at the risk of being extinguished, in these circumstances even the strictest sect of economists do not now insist on the necessity

<sup>1</sup> H. C. Adams, *Public Debts*, 1888, p. 107.

<sup>2</sup> Sir R. Peel, Speech at the Merchant Taylors' Hall, 11th May, 1835.

<sup>3</sup> O. M. W. Sprague, "The Conscription of Income," in *Economic Journal*, xxvii. p. 7; J. E. Allen, in *Industry and Finance*, [1918], Appendix, pp. 850, 851.

<sup>4</sup> S. J. Chapman, *Outlines of Political Economy*, 1917, pp. 409, 410.

of meeting from year to year the expense which a war entails<sup>1</sup>." Borrowing, within due limits, is in fact an element in national power, and Nebenius recognised in the most ample terms the stupendous influence of British credit in the liberation of Europe at the beginning of the nineteenth century<sup>2</sup>. Thus a failure to use the nation's credit in a great war would be a sacrifice of combatant efficiency through a mistaken economic pedantry.

Further the "all tax" method, if applied in practice, would result in a very curious paradox—its object is to avoid loans, but the amount of taxation required would be certain to induce loans through the magnitude of the taxes forcing the contributors to borrow in order to pay their taxes. And so the position is reached that a method is recommended in order to avoid borrowing which on the contrary compels borrowing. It is true that in this case loans would be made not to the State, but to individuals, but the resulting pressure upon credit, when it would be already subject to some strain, would soon become severe with the risk of grave consequences. Not only so, but this paradox at once produces another. One of the modern arguments against loans is that they cause inflation of prices. So far as they have this effect it is not attributable to loans, as such, but to undue subscriptions by banks to loans. Now it is probable that sufficiently high taxation would compel more loans to be made by banks to taxpayers to meet their taxes than these institutions have paid in on their own account for their own holdings in war loans. Accordingly, the probabilities are that very high taxation would cause more inflation than a well-devised system of borrowing.

It follows that, from the aspect of the successful conduct of war, much is to be said for a policy of borrowing as being likely to be most productive of the supplies required. But productiveness may appear to come into conflict with equity. Borrowing means taxation in the long run, and therefore the question resolves itself into a choice between immediate and deferred taxes. The practical difficulty in respect to the latter is in distributing

<sup>1</sup> F. Y. Edgeworth, *The Cost of War*, 1915, p. 11.

<sup>2</sup> F. Nebenius, *Der öffentliche Credit*, 1820, pp. 317-55.



the necessary levies when the time comes. The diversion of large amounts of capital (which would have been employed productively) to largely unproductive uses is likely to re-act unfavourably upon the future position of the wage-earning classes<sup>1</sup>; and, accordingly, if they are subjected to increased taxation after the war in order to pay something towards its cost they are in danger of suffering doubly, partly by being in a less favourable position to dispose of their labour, partly by the new taxes. Those who rest on this line of argument might well repeat to the less well-to-do the lines which Massinger addressed to the Earl of Pembroke:

Why should you  
(Pardon my boldness) pay more than his due,  
Be the debt ne'er so great<sup>2</sup>!

But there is another side, new capital, accumulated during the war, is in an apparently favourable position in so far as an abnormally high rate of interest is paid; and, after peace has been declared, the loans may be saleable at a premium, while several have been floated with a bonus on redemption. Not only so, but in terms of things, there is a further apparent bonus, in so far as the purchasing power of the money subscribed will almost certainly be less than that of the money in which the loan will be redeemed, since at the later date prices may be expected to have fallen. So it would appear that the situation justified the censure of Sheridan when he satirically described the seeming noble alacrity of the citizens to contribute to the necessities of the State as patriotism "cringing for its bonus<sup>3</sup>." But the bonus in the form of higher interest, a small appreciation of capital,

<sup>1</sup> A. C. Pigou, *Economy and Finance of the War*, 1916, pp. 42-47, 66-83.

<sup>2</sup> P. Massinger, *Works* (ed. Hartley Coleridge), p. 442.

<sup>3</sup> J. B. Sheridan, Speech on the New Assessed Taxes Bill in 1797. "If a native inhabitant of Bengal or China were to be informed that in the west of Europe there was a small island, which in the course of one hundred years contributed four hundred and fifty millions to the exigencies of the State, and that every individual, on the making of a demand, vied with his neighbour to subscribe, he would immediately exclaim, 'Magnanimous nation! you must surely be invincible.' But far different would be his sentiments if informed of the tricks and jobs attending these transactions, where even loyalty was seen cringing for its bonus!"

and any further bonus through a fall in prices is, to a large extent, an incentive to overcome a hardship inherent in the circumstances. Though war produces changes in the distribution of income which bring a surplus to a few which can be lent without inconvenience, in order to secure the increase in saving which is necessary, the rate of accumulation must be greatly augmented, and in the majority of cases the saving involves greatly increased hardship. Accordingly, a very marked increase in the real compensation for such saving is far from inequitable. On the whole, in a typical case, it is probable that the real aggregate reward for war saving will be less, and not more, than it would have been for normal saving by the same person if there had been no war, when the consequent sacrifices are taken into account. On the side of labour it is to be observed that no taxation should be imposed upon any worker of whatever kind which would impair his efficiency. This is not only equitable, but is necessary because, otherwise, the recovery after the war would be delayed unduly and by avoidable causes. The securing of the freedom of the nation is an object of the highest concern, and it is right that each citizen who has a surplus beyond what is required for necessities, should contribute his share, however small, because he is in enjoyment of the benefits to secure which that cost was incurred. What that share will be must be determined in view of the new circumstances which will have then arisen, and equity would seem to require a cautious but still a distinct progression in the taxation of the higher incomes.

Equity in taxation has so many variations that it justifies the saying of Selden in another connection that "Equity is a roguish thing<sup>1</sup>." If this principle should be thought to point in a different way from that of productivity in securing funds for war, the latter is to be preferred to the former. As Dr Marshall has said, "even in the interests of equity, canons based on the mere consideration of equity are often of but secondary importance in practice<sup>2</sup>."

Connected with these considerations there is another akin to

<sup>1</sup> J. Selden, *Table Talk*, 1890, p. 49.

<sup>2</sup> *Memoranda on Imperial and Local Taxes* [C. 9528], p. 114.



them. If the choice is between immediate and deferred taxation, why should the burden be postponed, would it not be better to meet it at once and leave the future unembarrassed? As Ricardo put it, "20 millions in one payment, 1 million per annum for ever, or £1,200,000 for forty-five years are of precisely the same value<sup>1</sup>." In figures this is true, but it is questionable in terms of the sacrifices involved and their concomitants. The mere fact of giving the taxpayer time to adjust himself to a new and heavy burden will lighten it materially for him<sup>2</sup>. Also industry will be given a chance of expanding to provide a part of the new impost. But for both results time is necessary, and this points to advantages—some probable, others contingent—in deferring taxation for a part of war expenditure.

There is another line of thought which tends to the same conclusion. Taxation represents an abstraction of a certain amount of the satisfaction to be derived from the possession of an income. Most reasoning concerning the sacrifice demanded by taxation proceeds upon the assumption that in normal times on the average there are no great variations in these satisfactions. But war changes all this, and the mass of the people become involved in a whole series of new sufferings and anxieties. The general suffering of the Napoleonic wars was described in graphic terms by Robert Hall, "The people are drained of the most precious part of their population, their youth, to repair the waste made by the sword. They are drained of their wealth by the prodigious expense incurred in the equipment of fleets and the subsistence of armies in remote parts.... The fearful catastrophes, the strange vicissitudes, the sudden revolutions of fortune which, thinly scattered heretofore over a long tract of ages, poets have collected and exhibited to the terror and commiseration of mankind have crowded upon us with so strange a rapidity and thickened so fast that they have become perfectly familiar and are almost numbered amongst ordinary events. Astonishment has exhausted itself; and, whatever occurs, we cease to be

<sup>1</sup> D. Ricardo, *Works*, 1852, p. 539.

<sup>2</sup> Professor Edgeworth has an ingenious formula for correcting Ricardo's statement. *The Cost of War*, p. 37.

surprised<sup>1</sup>." There are great non-economic sufferings to be borne, and it would appear equitable and expedient not to add to them during the war by purely economic burdens which may be postponed with safety.

If these conclusions be pressed to their logical issue they would seem to lead to the view upon which Germany has been acting that all special war expenditure ought to be borrowed, even as has been maintained there the interest on war loans should be postponed. But to appreciate this trend of thought it is necessary to be clear about its implications. It is based upon the conception that the State is a necessity of civilized existence. Therefore whatever the State requires must be procured, and the fact that the State feels this want shows that in a higher sense it is productive for the country. From that point of view the extraordinary expenditure upon war is of the nature of capital outlay—the present generation fight and future generations pay the cost. The main conclusion is strengthened by the suppressed premises in the mind of most recent German writers, namely that wars would be short and large indemnities would be secured. Thus sufficient time would not elapse for large war taxation, if levied, to bring in a revenue, while the anticipated indemnities would render taxes during war unnecessary. But the continuance of the present war has proved the illusory character of the first expectation, and its final result may be expected to falsify the second even more completely, at least as far as Germany is concerned.

The conception of the German State appears to me to lead logically to an "all tax" rather than an "all loan" policy; for, according to that conception, the State would be able to make a better use of the resources of its people than the people could themselves. But, in practice, this issue may be limited by what some one has called the unwillingness of the rulers of a nation (which has little true freedom) to impose heavy taxes upon it.

Even if a war be financed at the beginning exclusively by borrowed money, experience points to the wisdom of adding a sufficient amount to the existing taxes to cover the interest upon

<sup>1</sup> R. Hall, *Works*, 1832, I. pp. 92, 155.

the new loans. If the war lasts into a second year, the absence of revenue to cover the interest would re-act unfavourably upon the national credit. In the case of Germany the want of facilities for the raising of foreign loans has concealed the evils of an erroneous system of finance, but those effects remain and they have weakened Germany's effort during the war and still more they will delay her recovery when the war is over<sup>1</sup>.

If follows, then, that the financing of a great war should be conducted by a combination of immediate taxation and of borrowing. But there still remains the determination of the ratio which ought to subsist between the two sources of revenue, so that they may be articulated as parts in a uniform plan. Upon several grounds taxation should be increased to a sufficient extent to meet the interest upon war loans. Those loans should be issued (as they can be) in a manner which will not produce inflation. This leads on to a doubtful point, namely, should new revenue be sufficient to cover interest on the debt actually contracted at the date of the Budget, or, in addition to that, to provide interest for the further loans which will probably be floated during the current financial year? Of these alternatives the second is to be preferred. Next, should the Budget raise by taxation a further sum sufficient to provide for a sinking fund for the redemption of the debt? That is not necessary, and would be in some respects undesirable. It would be better that the excess of revenue which is raised by taxation, in addition to the normal income and the charge for interest accrued and accruing, should be devoted to extinguishing war costs, thereby preventing the growth of debt. Is it possible to determine to what extent it is advantageous to augment war taxation beyond the necessary limit already prescribed? Here very much will depend upon the wealth of the country, the previous rate of taxation, and how the nation in question, its territory and its trade have been affected by hostilities. As regards Great Britain,

<sup>1</sup> It is interesting to note that in the fourth year of war both German and Austrian public men have begun to admit, reluctantly, the superiority of British financial methods, as for instance Dr Küzyuski in the *Weser Zeitung*, and Baron Plener in the Reichrath, both in October, 1917.

in the present circumstances, it is the duty of the Chancellor of the Exchequer to keep his finger upon the pulse of the country's trade imposing new taxes and increasing old ones, when necessary, until they begin to yield a balance of disadvantage by injuring trade, by diminished productiveness of the revenue and by producing other evils. All taxes inflict some damage, and it is a matter of the most delicate skill to forecast whether the anticipated gain will outweigh the various fiscal and other inconveniences. Taxation should stop before these limits have been reached; but, in my judgment it should be pushed upwards until the verge of those limits has almost been touched. There is another limit, though of less importance. During a war, such as this, which makes great demands upon the human energies of the country, it is needful to economise labour in the collecting of taxes. Hence new and fairly productive imposts might be temporarily undesirable through want of the labour which would be required to collect them.

It is difficult, if not impossible, to translate the principles of war-taxation, which have been outlined, into a concrete estimate of the amount which ought to be raised by taxation<sup>1</sup>, say in the financial year 1918-19. On the whole and subject to the various conditions already indicated, it may be estimated that 900<sup>2</sup> millions should be aimed at, and even more, in that year. The amount may seem formidable, but it must be borne in mind that the real produce of taxation consists of the things which the Government is able to obtain by use of the money it levies. But the rise in prices has affected the quantity of these things procurable from a given rate of taxation. As prices rise, in order to keep up merely the same flow of munitions and supplies, the nominal amount of taxation must rise roughly in proportion. Therefore 900 millions does not go as far now as a smaller sum a year ago. In July 1915 Professor Bastable estimated that under emergency pressure and for a limited period 500 millions

<sup>1</sup> Under this head there is included the so-called "non-tax" revenue.

<sup>2</sup> It is to be remembered this sum does not exhaust the "taxation" paid. In addition there are all onerous rates. The sum of 900 millions mentioned in the text is that which it is expected the Budget of April 22nd will realise in a complete year.

per annum might be raised<sup>1</sup>. But by July 1917, owing to the rise in prices, it would take on the average about 825 millions to purchase the things obtainable at 500 millions in 1915 and at the prices of December 1917 about 890 millions<sup>2</sup>, so that it follows that the estimate of Professor Bastable, which is based on certain standard principles, has been adapted to the alteration of prices and stiffened a little, on the one side to correct some factors which scarcely received sufficient prominence<sup>3</sup>, and on the other side in view of the deplorable extravagance which is still to be observed and which, clearly, would be a suitable subject for further taxation, if it can be reached. Even if it should prove possible to raise 900 millions by taxation in 1918-19, at the present rate of expenditure over 2,000 millions must be found in other ways. Allowing for the proceeds of sales of securities and other credits abroad and for foreign loans, by far the larger part of this sum must come from the savings of the people. The money can be found in this way, but the economy campaign must be prosecuted more vigorously and more continuously. In fact, all income which exceeds that required for the vital needs of the recipient should not only be saved, but also be lent immediately to the State.

<sup>1</sup> *Credit, Industry and the War*, 1915, p. 244.

<sup>2</sup> Considering the character of the disbursements of the Government, it is possible that the full measure of the rise in prices has not been felt by it. If so, the sum required to purchase the things and pay the services (which would have cost 500 millions in 1915) would be less than the amount stated in the text.

<sup>3</sup> It seems to me, in view of later experience, that Professor Bastable may have under-estimated the National Dividend in 1915.

CONSCRIPTION OR PROSCRIPTION  
OF CAPITAL

Il y a plusieurs grands Docteurs en matières d'impôts, qui sçavent beaucoup de moyens de faire fonds aux finances, mais ils n'ont jamais eu le vraye science d'honneur, n'y la prudence politique.

BODIN.



## CONSCRIPTION OR PROSCRIPTION OF CAPITAL

IN the previous argument the general conclusion has been that in war finance the balance of advantage remains upon the side of a judicious combination of taxes and loans, where the ratio between them is determined upon the principles which have been established. In that enquiry full consideration has been given to many schemes which aim in different ways at augmenting the amount to be obtained from taxation. These plans are often so constructed as to point in two different directions. On the one side they may be directed towards raising the greater part of war expenditure by taxation while the war is in progress; or, on the other side, they may advocate measures for extinguishing a part of the debt, which the war will leave behind it, by some special tax or levy designed for this purpose. It follows that schemes of the latter type will require separate examination before any attempt is made to investigate the conditions which may be expected to govern finance in the early years of peace, since a large part of the revenue (which will then be required) will depend to a large extent upon the amount of debt outstanding, and consequently a reduction in that total would react both on the annual charge for interest and redemption.

The external form in which the current proposals of this type have been expressed has been determined by the operation of the Military Service Acts. Thus there are many references to Conscription of Wealth, Conscription of Income and Conscription of Capital. The names are new, but the idea is very old. During War all schemes for meeting the whole cost within the year might be made topical by being described as a Conscription of Wealth, while the compulsory reduction of debt upon a great

scale after the end of a war has been the goal of many ingenious schemes. One of the earliest and most thoroughgoing of these was drawn up by Archibald Hutcheson, just two hundred years ago. In addition to a plan for redemption of the land tax, he proposed that one-tenth part of the National Debt should be cancelled or, as he euphemistically termed it, "remitted," likewise one-tenth part of all other net personal property should be taken from the owners and devoted to the repayment of debt, also one-tenth of those incomes, now termed "earned," should be collected, annually, and devoted to the purchase of Government stock<sup>1</sup>. Thus the proposal amounted to a levy of 10 per cent. upon the total value of all property together with a like percentage assessed annually upon salaries and perquisites. The proposals of Asgill and Barbier of the same period were based upon methods of conversion of debt into notes, upon the analogy of some of the operations of John Law. These plans, if adopted, would have caused very great inflation. In 1750 Hooke proposed a less drastic scheme which aimed at a large ultimate reduction of debt by a voluntary conversion into annuities<sup>2</sup>. After the Napoleonic Wars a general contribution or general assessment was proposed from time to time, but Ricardo urged that there was a precedent condition, namely that the country must be "resolutely determined" not to create new debt under any circumstances. In that case he approved of a tax on property for paying off the debt once for all<sup>3</sup>. Again, after the Franco-Prussian War, Menier propounded his tax upon fixed capital in order to readjust the finances of France. So far from obtaining support he was described as a revolutionary, his articles were refused by the leading economic journal, his books were not allowed to be sold on the public bookstalls, while he felt most of all the taunt—"De quoi se mêle-t-il? Où il reste donc à faire son chocolat<sup>4</sup>."

What was considered revolutionary in the seventies has now

<sup>1</sup> A. Hutcheson, *Collection of Treatises*, 1720, p. 27.

<sup>2</sup> A. Hooke, *Essay on the National Debt*, 1750, p. 44.

<sup>3</sup> Ricardo, "Essay on the Funding System," in *Works*, 1852, p. 545.

<sup>4</sup> Menier, *L'Impôt sur le Capital*, 1874, pp. 25, 26, 473-485.

become a commonplace of Labour oratory and is advocated in other quarters with considerable persistency. That advocacy of drawing upon wealth in some way in order to meet the material cost of war originates from an ideal which is no ignoble one. Life has been given without stint, and it is natural to expect the lesser sacrifice of money. Hence it is asked "if life be conscripted, why not wealth also?" The question is pertinent, and the answer to it requires to be made as precise as possible. While war is in progress, the State is entitled to demand the service of the people and of their wealth in that form which is judged best for the preservation of the country's permanent interests. Faced by the supreme need for the maintenance of free institutions, there can be no doubt that both the effort and the material resources of the citizens must be directed and controlled by the State in order to accomplish the most vital object that has arisen in the national life for a century. Each has functions which it can discharge in respect to the waging of war, and the claim upon each for its own duty is of equal force. Further, in so far as there can be any substitution of one for the other, it is unquestionable that material resources should be employed, and if need be sacrificed, in order that life may be conserved.

So far there can be little difference of opinion; but, as Epictetus pointed out long ago the difficulty is in the application, many evils arising from using general principles in a manner which does not fit particular cases<sup>1</sup>. Conscription both of service and of wealth is exceedingly partial. As regards the former it does not apply to all those, who by reason of age, sex or deficient physique are not considered capable of rendering efficient military service. Thus, since personal service is of varied character, the State claims that which it requires for the defence of the country. Further, while it demands that service, it does not take it without compensation; since, though soldiers' pay, allowances and pensions remain inadequate, the principle of an economic consideration is admitted. Similarly, various forms of wealth, such

<sup>1</sup> Τοῦτο γὰρ ἐστὶ τὸ αἴτιον τοῖς ἀνθρώποις πάντων τῶν κακῶν, τὸ τὰς προλήψεις τὰς κοινὰς μὴ δύνασθαι ἐφαρμόζειν τοῖς ἐπὶ μέρους. *Diss.* IV. 42.

as factories, ships and hotels for government offices have been taken over or "conscripted," sometimes upon no more defined method than an *ex gratia* payment. From the point of view of waging war the abstract term "Wealth" is likely to mislead. Certain kinds of wealth are of use, others are not. The Government has "conscripted" property valued at many hundreds of millions, giving compensation roughly upon the approximate basis of pre-war earnings. There is a possibility of misapprehension at this point. Conscription of service does not necessarily mean conscription of life. The State restricts personal liberty by demanding the services of perhaps 15 per cent. of the population for which a compensation is given, which may be more than the person was earning previously; but, even when all allowances are considered, is more often less. The soldier runs various degrees of risk of loss of life or disablement through wounds or disease according to the arm of the service to which he belongs. Thus the demand upon him is not for his life, but to risk it, if his duty requires. Some of those who speak of conscription of wealth seem disposed to use this term in the sense that all the wealth required for carrying on war should be taken by the State without compensation and that there should be no return of it to the owners. The risk, as affecting wealth, would be arranged as in the plot of David, so that in the report of "all the things concerning the war," there would be the sinister conclusion "and thy servant Uriah the Hittite is dead also."

If it be assumed that the State decided to apply the principle of conscription both to services and wealth upon an equality, as far as the nature of each permits, it may not be wholly unconstructive to endeavour to develop the working of this principle in practice. All services of every kind would come under a new Act combining military and national service. Everyone would be allocated his or her service as judged best by the monster Department concerned and at rates of pay which would certainly not be more and probably should be less than those for corresponding ranks in the forces when all allowances were included in each case. All those drawing income from investments would, as it were, be deemed to be minors. The whole of their unearned

incomes would be devoted to paying the expenses of the war, except in such cases as the recipients were unable through reasons of ill-health or age to perform any useful work, when they would receive an allowance for their support. As affecting earned incomes the same principle would mean that the worker, who before the war was unskilled and was making over £800 a year in 1917<sup>1</sup>, would be reduced to about 10 per cent. of that amount (say from £80 or £90) together with his billeting allowance. Similarly the man who had earned £8,000 a year would obtain, for the period of the war, whatever his service was considered worth. It might be private's pay or that of a commissioned officer, not according to his capacities in peace time but as these were valuable or the reverse in war. This is the principle of conscription developed logically. It is in fact the basis of that conscription of income which is advocated by Professor Sprague<sup>2</sup>; and in a less precise form, but with the same general purpose, by Mr Hartley Withers<sup>3</sup>. There is something to be said for this scheme, particularly if it had been adopted early in the war. It would, or at least it should, have prevented those bonuses to labour and capital which have been reprobated by Professor Nicholson<sup>4</sup>. When, however, the magnitude of the task is considered, the ill success in the utilisation of man-power upon a smaller scale and the growth of public extravagance till "it has become a habit<sup>5</sup>," one must hesitate before giving any support to a scheme which would almost infallibly smash the straining machine of Government.

In an address to the staff College at Camberley in 1911 Sir William Robertson drew attention to one of the psychological reactions of peace upon preparations for war. He said "the longer peace continues, the more difficult it is to prepare for war, for the usages of peace have a habit of pushing themselves more and more into prominence, until they assume the appearance of

<sup>1</sup> *Commission of Enquiry into Industrial Unrest*, No. 4 Division, Report (Cd. 8665).

<sup>2</sup> *Economic Journal*, xxvii. pp. 1-15.

<sup>3</sup> *Our Money and the State*, 1917, p. 25; *Economist*, Dec. 15, 1917.

<sup>4</sup> J. S. Nicholson, *War Finance*, 1917, pp. xx, 395-399.

<sup>5</sup> *Ibid.* p. 435.



war conditions and begin to be regarded as such<sup>1</sup>." As the war becomes protracted the reverse tendency has begun to establish itself; and people, almost insensibly, grow accustomed to think of war conditions as if they were permanent. Amongst men of alert mind there is needed, in the present situation, a species of "double consciousness," upon the one side to strive earnestly for the maximum effort to give effect to the national ideals in the present; and, upon the other side, to keep steadily in view the resumption of life upon the usual conditions of peace in the future. Thus, at the same time, they must act abnormally and think normally. In such difficult conditions the view expressed in the previous course of lectures, namely that the aim should be the minimum divergence from the organisation of life in peace time, which will secure full efficiency for military effort, has become strengthened and confirmed<sup>2</sup>. The difficulties in the demobilisation of the army and the diversion of labour from the work of war to that of peace will be sufficiently great without adding to these the enormous task of the vaster and more complicated demobilisation of the whole of the remainder of the population, and the simultaneous attempt to wind up the great national trust which would have been constituted to hold the property and wealth conscripted. The result would be that it would be discovered that the greater part of the material productive power of the nation had fallen into Chancery:

Like money by the Druids borrowed  
In the other world to be restored<sup>3</sup>.

Industry and commerce would be hung up in re-starting after peace to an extent which would be both protracted and dangerous.

Analysis proves that this conception, when developed, would be impracticable. But, at least according to the view of Matthew Arnold, we are not distinguished as a nation for consistency<sup>4</sup>; and, it may be, that the idea may be applicable in part, though not as a whole. In other words, while the complete

<sup>1</sup> G. A. Leash, *Sir William Robertson*, p. 104.

<sup>2</sup> W. R. Scott, *Economic Problems*, First Series, pp. 34-35.

<sup>3</sup> S. Butler, *Hudibras*, Part III, 975.

<sup>4</sup> M. Arnold, *Essays in Criticism*, 1884, p. 12.



transformation of the distribution of wealth, as an emergency measure for the period of the war, would result in more loss than gain, it may be worth enquiring whether some temporary modifications during that period may be less disadvantageous. This it will be observed is a much more humble enquiry. The vague, if perhaps magnificent, idea of an omniscient State—the war-time trustee for all wealth which it assigns to the population it employs—must be abandoned; and finding the *Leviathan* of Hobbes inert, we must content ourselves with the advice of the sage in Johnson's *Rasselas* that “the memory of mischief is no desirable fame<sup>1</sup>.” There may be temporary and less ambitious readjustments of spending power amongst the members of the community in which the element of national disadvantage will be a minimum, and there will be considerable advantages. Under the method of war economy, which is being followed, wealth is being made to play its part in the contest by the Government taking over for the purposes of the war certain things in which it has been embodied, such as railways, ships and buildings, upon terms that afford a smaller compensation to the owner than if he had remained free to use these things for his own interest. Also, taxation upon all wealth, which yields an income above a small minimum, has been more than quadrupled; and in addition, Excess Profits Duty takes away four-fifths of all earnings of businesses in excess of the pre-war standard. There is a large measure of conscription of wealth in these arrangements. But as compared with conscription of men there is a difference. The man runs risk through his military service, wealth does not through the service which it renders either in being used temporarily by the Government or in paying taxation. It seems not unreasonable that, as suggested by Professor Pigou<sup>2</sup>, those who run no personal risk should pay extra taxation, in addition to the difference in the rate of Income Tax which has already been conceded to officers and men serving in the Forces. A tax of this type is already levied in Italy. What should be the rate of the suggested tax? Upon the basis now outlined, it would follow

<sup>1</sup> S. Johnson, *Rasselas*, 1823, p. 109.

<sup>2</sup> *The Economist*, Nov. 15, 1916.

that its annual amount ought to be such a sum as would be required to insure the excess of any income above £130 for a period of one year. The successful defence of the country has in fact insured the incomes of its inhabitants from a grave risk, and it seems to be equitable that those, who undergo no personal danger, should be compelled to contribute to this extent, in addition to their other taxes. This view, it may be observed, is not what is called by Professor Seligman "the insurance premium theory of taxation<sup>1</sup>." It is rather the expression of a peculiarity of life during a period of hostilities, and is designed to recognise differences in personal risks. Where for instance in munitions-making there is danger of injury comparable to that upon general service, or if the inhabitants of a particular place suffered very many casualties from bombardment or attacks from the air, this special tax might be remitted.

The revenue derived from taxation would leave a large margin to be found by borrowing. The amount of economy which is required by those who provide the loans represents in the aggregate a great sacrifice. But the misfortune during three and a half years of war has been that it was most unequally distributed. Very great numbers of the people have begun to understand what the older economists meant when they described saving as "abstinence." The "waiting" which involves no more than the deferring of the satisfaction to be obtained from the spending of a part of an income, is intensified by the sacrifice of much that in happier days was considered almost a necessary of a moderately complete life. On the other hand, while many with stationary or declining incomes have managed to save, others who have obtained very great increases have certainly not saved in proportion; many, it is to be feared, have not saved at all. Moreover, saving as such does not exhaust the responsibility of the citizen. There are tempting opportunities for investment open to those who have opportunities of judging and can afford to wait. But wealth used in this way, is shirking the responsibility of its service in the conduct of the war. There is much to be said in favour of an act of the New Zealand

<sup>1</sup> E. R. Seligman, *Progressive Taxation*, 1908, pp. 165, 166.

Parliament which established a quota for subscription to war loans under a penalty. Every tax payer with an income not less than £700 a year was required to subscribe to the loan of 1916 an amount equal to one and a half times the total of his land tax and income tax, and to the loan of 1917 three times his payments to those taxes. Persons who failed to subscribe for the necessary amount of stock were liable for double the land and income taxes for one year<sup>1</sup>. A measure of this kind, with the New Zealand provision for appeal in cases of hardship and a much lower limit of income subjected to its provisions, would be advantageous in this country. It would also be beneficial in forcing payers of income tax to disclose their holdings of war loan and would facilitate the collection of this tax upon the later issues, the interest upon which is paid in full. There is also an important question of principle involved. And here it is necessary to draw a fine distinction. The penal tax is not required in order to provide sufficient subscriptions to loans. In one way or another these will be furnished. But such a tax would be convenient as a species of fine upon unpatriotic expenditure. Those who have sufficient incomes to invest in war loans, but refuse to do so<sup>2</sup>, are doing injury to the nation, if they spend the sums which could and should have been saved, either upon superfluities or an excessive quantity of necessities. They, in fact, are diverting labour from the essential needs of the time. In addition to the negative injury to the national cause of withholding the "sinews of war," these persons are doing positive damage by maintaining the diversion of services from war work to purely selfish ends.

Borrowing by the State, with some degree of compulsion, has been advocated at a lower rate than what the market rate may be supposed to be. To some extent this principle has already been applied in practice. Investments outside the Kingdom have been reduced to a very large extent; and, in addition, the Bank of England established in January a differential

<sup>1</sup> *Act of New Zealand Parliament*, Geo. V, No. 9, § 40.

<sup>2</sup> Capital expended upon works of national importance or used to supply the defect of working capital caused by delay in payments by Government departments, should be treated as invested in war loan.

rate as between home and foreign money, by which the latter is favoured by 29 per cent. The terms for Government loans in this country average less than those raised abroad; and while discounts on their issue and a premium upon redemption should be avoided as far as possible, it seems that further compulsion should not be applied until the saving habit is more firmly established. As the burden of taxation increases, the difficulty of saving will grow, and reduction in the rate of interest on new loans can only be attempted with the greatest caution.

Conscription of Wealth appears also to be used in another sense, as applying to the more durable things in which it is embodied. That view rests upon the error of taking figures for things. Granting that the wealth of the country in 1914 was 14,300 millions, it at first seems easy to suggest an arrangement by which the State will take the necessary amount for carrying on the war<sup>1</sup>. But the prices upon which this valuation was based have changed since 1914, and they would vary to an immense extent—and that unfortunately in a downward direction—if any attempt were made to effect a compulsory change of ownership from individuals to the State. If it be assumed that the Government would seize one-fourth of the wealth of the country, the widespread depreciation in values, which would ensue, would result, in terms of things, in the taking of perhaps twice or thrice as much. But this is by no means all. It is extraordinary how little of the great sum of 14,300 millions is in reality available for carrying on the war to any larger extent than at present. At the prices of 1914 one-third consisted of land, buildings and farming capital, and as much as one half of a variety of items some of which are used by the Government already as fully as if it owned them and others are not suitable for the purpose. These classes comprise the value of the National Debt owned in Great Britain, the railways and businesses of the country, mines, Government and municipal property. There remains, roughly, one-sixth which comprised investments abroad and movable property, such as furniture. It will thus be observed that immediately before the war five-sixths of the

<sup>1</sup> J. C. Stamp, *British Incomes and Property*, 1916, pp. 404, 405.

National Wealth was in the form of fixed capital and other property in this country. Suppose that the Government were unwise enough to claim a percentage of its value, the question of realisation would arise. Since the levy would be universal, it would be difficult, if not impossible, to find purchasers in this country, since those who had free funds available would require them to pay their own share of the levy. There was one instance of a great sale of this kind in our history which should be a sufficient warning. During the financial embarrassments of the Long Parliament, the Crown Lands and other forfeited properties were sold by the State. The prices realised represented about 25 per cent. of the values before 1640, and in some cases as little as 10 per cent.<sup>1</sup> Such a proposal would in fact result in the State being forced to sell the property it obtained at the rates of a sale of a bankrupt's stock. There is the alternative of selling the property received in payment of the proposed tax as far as possible abroad. In the case of joint-stock companies, it might be possible to make a market for their shares upon foreign stock exchanges. In that case, as regards the future of commerce, a mortgage would be imposed upon the productive power of the country in the form of the dividends which it would be necessary to export. Clearly, if the national freehold must be encumbered, it is better from many points of view, that the creditors should be fellow subjects rather than foreigners.

Accordingly it appears that, as regards about five-sixths of the National Wealth, the difficulties of realisation are insuperable. There is the remaining one-sixth. Its chief constituents were capital invested abroad and household effects. The former can be sold without difficulty, but much of it has been marketed abroad already. Possibly one half of the valuation of the latter might be realised, though with considerable loss. The difficulty would be to secure particulars of the effects in excess of the necessary minimum, otherwise there is something to be said for a levy of this kind. Costly movables, such as pictures,

<sup>1</sup> W. R. Scott, *Constitution and Finance of Joint Stock Companies to 1720*, 1912, I. p. 246.



statuary, plate and jewels represent the keeping of wealth in an unproductive form; and, while some of these have a certain educational value, in circumstances of financial pressure, there would be wisdom in reducing by exportation a stock of such things, which, though moderate in times of prosperity, may be excessive in altered circumstances. The case of foreign investments is different. From the standpoint of war finance these had a high value in correcting the foreign exchanges. They were "conscripted" in the sense that the State demanded the ownership or the use of them under a heavy penalty, but liberal compensation was given. The taking of such investments without compensation would have been inequitable as discriminating severely against the very securities which were capable of performing a valuable national service.

Yet another form of the plea for conscription of wealth is the suggested levy upon Capital which attracted some attention in 1917 and the early part of the present year. This scheme differs from that just described in so far as it may be taken to exclude some comparatively durable things which do not produce income. If applied in practice, it would tend to encourage the non-productive use of resources, and to that extent would be prejudicial to industrial recuperation on the return of peace, when Capital will be greatly needed<sup>1</sup>. Also there is the obvious inequality that those who have responded to their duty in saving, in order to provide funds for the prosecution of the war, would be penalised, as compared with others whose circumstances were similar but who had selfishly turned a deaf ear to the nation's need. Thus in very many cases this scheme would be a direct bonus upon unpatriotic conduct, and it would act as a deterrent towards accumulation in the future besides, probably, reacting upon the revenue by causing Capital to be placed outside the country and concealed. Without anticipating the enquiry still to be made concerning future taxation, it will be apparent that very considerable dependence must be placed upon direct taxation, and particularly upon Income Tax. The yield of this tax is peculiarly sensitive to the feelings of the tax-payers, and any

<sup>1</sup> W. R. Scott, *Economic Problems*, First Series, p. 94.



action which would leave a sense of injury amongst large bodies of those affected would, almost inevitably, produce that type of casuistry which professes to justify evasions<sup>1</sup>.

Some speakers and writers, who have given insufficient consideration to the consequences of their schemes, suggest an extinction of a part of the national debt without compensation. That would be, as far as all experience is any guide, the one infallible method of delaying indefinitely the recovery of the country after the war. In times of great trial in the past it was always the care of our ancestors to maintain "the inviolability of the public faith." Defoe described England in 1720 "as poor in being encumbered in debt, speaking of the publick state of things as a government, and yet with all this, while the publick credit remains, we can never be said to be poor<sup>2</sup>." All those who took note of projects for a partial repudiation of the debt during the Napoleonic wars speak of them with scorn and contempt. Hamilton says "the extent of distress attending a public bankruptcy, whether brought on systematically or overtaking us as the necessary consequence of our being overwhelmed with the magnitude of our debt, would be so great; the present overthrow of everything valuable so compleat; and their future extrication so uncertain, that we can hardly conceive a greater public evil<sup>3</sup>." Coleridge, too, shows in a passage of great power that it is not to the interest of merchants, farmers, or labourers to refuse to pay interest upon the debt, and he concludes "least of all could it be the wish of the lovers of liberty, which must needs perish, or be suspended, either by the horrors of anarchy or by the absolute power with which the government must be invested in order to prevent them. In short, with the exception of men desperate from guilt or debt, or mad with the blackest ambition, there is no class or description of men who can have the least interest in producing or permitting a national bankruptcy<sup>4</sup>."

In these views the close relations between taxes upon income

<sup>1</sup> E. R. Seligman, *Shifting and Incidence of Taxation*, 1910, p. 328; *Essays in Taxation*, 1895, p. 31.

<sup>2</sup> [D. Defoe], *The Chimera*, 1720, pp. 7, 8.

<sup>3</sup> R. Hamilton, *National Debt*, 1813, pp. 33, 34.

<sup>4</sup> S. T. Coleridge, *The Friend*, Misc. I, § 1, Essay 7.

and upon Capital must not be overlooked. A tax imposed upon Capital may fall upon income, and conversely<sup>1</sup>. A heavy tax upon income may be largely paid out of Capital, a light tax upon Capital may be met, to a great extent, from income. In addition to the magnitude of the tax, the attitude of mind of the nation taxed must be taken into account. A saving people will make extraordinary sacrifices in order that each individual may keep his capital intact; while, on the contrary, where the general habit is that of profusion many will resort to their capital in order to meet taxes upon income. From this point of view the question resolves itself into the weight of taxes in excess of what may be described as the necessary minimum, namely that required for civil government and for interest upon debt. A great increase beyond that amount, for reasons given in the previous lecture, would be likely to produce a balance of disadvantage.

When the consequences of the conscription analogy are developed logically, they lead to some curious results. Is a capital levy to be applied to all capital? If so, the capital of those, who have served on the sea or in the field, would be included, and the somewhat confused basis of the scheme is wrecked. For capital is to be conscripted on the ground that its owners have not been subjected to the same risks as many other persons. If that capital were excluded from the levy, the yield would be greatly reduced. But in practice such exclusion would be difficult. The soldier, who owns no property but who has a large insurance upon his life, would be entitled in equity to the exemption of this amount from the special tax, if such exemption were granted to members and ex-members of the forces, but it would be exceedingly difficult for insurance offices to differentiate between service and civilian policies in order to obtain a rebate of the capital levy upon the former. Further, the men who have served would be subjected to a further hardship in so far as many have "reasonable expectations" of inheriting from their families. It seems hard measure to mete out to these men, that while they are risking their lives or immediately they return, their country shows its gratitude by imposing a dif-

<sup>1</sup> C. F. Bastable, *Public Finance*, 1903, pp. 290, 673.

ferential tax either upon their property or that to which they are entitled to succeed. Thus the argument from equity, when fully developed, leads to the paradox that in the end but little wealth would remain to which the tax could be justly applied—*parturiunt montes, nascitur ridiculus mus*. Indeed, upon principles of equity, any Government which proposed a levy upon the capital of men who had served would be in an altogether untenable position. Less merciful than the highwayman it would demand not a man's money *or* his life, but both his life *and* his money.

There is a more serious aspect of the question—namely assuming that a levy on Capital were practicable—what is the capital that should contribute? This is far from being the simple matter which it appears. In this discussion Capital is commonly confined to material capital only, but there is immaterial Capital also, and it seems equitable that this also should be called on to bear a share of special taxation adapted to its peculiar conditions. Mill has discussed this problem in a striking passage—“If property bore the whole interest of the debt, property might, with great advantage to itself, pay it off; since this would be merely surrendering to a creditor the principal sum, the whole annual proceeds of which were already his by law; and would be equivalent to what a land-owner does when he sells part of his estate to free the remainder from a mortgage. But property, it need hardly be said, does not pay, and cannot be made to pay, the whole interest of the debt. Some indeed affirm that it can, on the plea that the existing generation is only bound to pay the debts of its predecessors from the assets it has received from them<sup>1</sup>, and not from the produce of its own industry. But has no one received anything from previous generations except those

<sup>1</sup> Mill had the debt of the Napoleonic wars in mind when he wrote. He however takes no account of the effect in a reduction in the rate of interest upon Government debt. Thus the tendency of redeeming the “mortgage” of taxation is towards that mortgage being capitalised at the proportion of the annual revenue required for the service of the debt at the rate of interest paid during war; whereas the real rate would be the present value of a charge at 5 per cent. for  $x$  years, falling say to 4 per cent. after  $y$  years and perhaps to 3 per cent. after  $z$  years.

who have succeeded to property? Is the whole difference between the earth as it is, with its clearings and improvements, its roads and canals, its towns and manufactories, and the earth as it was when the first human being set foot on it, of no benefit to any but those who are called the owners of the soil? Is the capital accumulated by the labour and abstinence of all former generations of no advantage to any but those who have succeeded to the legal ownership of part of it? And have we not inherited a mass of acquired knowledge, both scientific and empirical, due to the sagacity and industry of those who preceded us, the benefits of which are the common wealth of all<sup>1</sup>? ” Mill’s queries have become more pertinent through the lapse of time since he wrote. The industrial system, with all its faults, provides an instrument which men of energy can use so as to make a surplus above their needs. Similarly, the advantages of free or subsidised education, both in the schools or the Universities, constitute an essential instrument for the production of immaterial wealth. Considerable incomes, which depend upon these aids, are not strictly speaking wholly earned. Theoretically, they are separable into two parts, one of which consists of the proportion assignable to the aid of immaterial capital; and, in principle, a capital levy, if made, should apply to this as well as to material capital. From this point of view, the proposal to tax capital is subject to the same exception in the favour of the critic as was noted by Samuel Butler in regard to self love:

And though all cry down self, none means  
His own self in a literal sense<sup>2</sup>.

Finally there is a variant of the Capital levy which calls for separate consideration. This is the “heroic measure” of a Special War Levy as “an entirely exceptional expedient” soon after the termination of the war for the extinction of a part of the debt. It is proposed that all persons owning £100 worth of property should “be deemed to be dead,” and would be liable for this Special Levy of 10 per cent. upon the total value of their property. The tax would be collected in equal instalments of

<sup>1</sup> J. S. Mill, *Political Economy*, v. 7, § 2.

<sup>2</sup> S. Butler, *Hudibras*, Pt. II. 459.

1 per cent. per annum for ten years, and, combined with a special poll tax of 10s. per head for the same period, applicable to all persons earning over 30s. per week, is expected to realise 1,200 millions<sup>1</sup>. Incidentally it is unlikely, for the reasons already stated, that the proposed taxes would produce the estimated amount. An objectionable feature is that there is no provision for reaching those who, having earned moderate or considerable incomes, have refused to save and thus have no property upon which the Special War Levy would fall. Even, with special tenderness to the salaried classes, the "paraphernalia" of the house (e.g., furniture, clothes, etc.) up to "perhaps a maximum of one or two thousand pounds" is excepted. This produces the following grotesque result. *A* and *B* have each an income of £2,000 a year. *A* is a professional man with a salary of this amount. He has no savings and his furniture is less than amount exempted from the levy. *B* realised his property and invested it in War Loans, adding considerable amounts as the result of strict self-denial during the War. Under this scheme the unfortunate *B* is liable to additional taxation of £4,000. What might *A* be expected to pay in view of the immaterial capital embodied in him and also through his failure in contributing to the needs of the State? Would £200 a year be too much during the ten years, making £2,000 against the £4,000 demanded from *B*? It is scarcely to be credited that, as far as the plan has been disclosed, against *B*'s contribution of £4,000, *A* is required to pay only £5 in instalments spread over ten years. In other words *B* is asked to surrender approximately £400 a year—while *A* magnanimously contributes towards the reduction of the National Debt the cost of a half penny paper during five days a week!

Nor is this all. In practice the Special War Levy resolves itself into a differential income tax upon unearned income with a fringe covering such capital as does not yield interest or dividend. The latter may easily be overestimated. For instance all the railway stocks (Debenture, Preference and Ordinary) of

<sup>1</sup> *How to pay for the War* (ed. S. Webb), 1917, pp. 263-5; *Great Britain After the War*, p. 78.



the railways of the Kingdom, which pay no dividends and are quoted upon the London Stock Exchange, are nominally close on 40 millions, but their market value at the making up prices of January, 1918, was less than two millions. Dividendless securities are held in the expectation of income at a future date. If such hopes are persistently disappointed, their value declines till it becomes little more than nominal.

The proposed Capital Special War Levy is superimposed upon an income tax which inevitably must be high. No doubt, if financial methods were sound, taxation could be reduced to the extent that debt was extinguished, thereby diminishing the sums required for interest. But that benefit, which cannot be accepted without further enquiry, would be secured at the expense of those who owned capital at the time the Levy was established, and it would free *pro tanto* the large fortunes which will no doubt be made as a result of the activity in business arising out of restoration of the damages of war, as well as high salaries which will continue to be distributed. As regards businesses of all kinds the consequences would be unfortunate, for the tendency would be to deplete working capital at a time when practical wisdom urges its increase in order to meet the severe foreign competition which will have to be met in the attempt to regain overseas markets. In fact industry, upon which our national recovery will depend, is to be severely handicapped in the interests of the professional and salaried classes.

Further the Levy would discriminate against the formation of new capital. Dr Marshall has sounded a warning against heavy taxes on Capital. He points out that "ethical considerations and those of high policy make alike for the preservation of the Capital that is needed to sustain the strength of a country in peace and when assailed by hostile aggression." He adds that "taxes on Capital must be handled with caution<sup>1</sup>." Whatever solemn declarations were made by Ministers (who were sufficiently unwise to introduce such a tax) as to its unique and exceptional character would be received with contemptuous incredulity by those who smarted under what they felt was a gross

<sup>1</sup> *After the War Problems* (ed. W. H. Dawson), 1917, pp. 322, 323.



and palpable injustice. They would feel that an expedient of this type might, and probably would be repeated in the future. Accordingly, the incentive to accumulation would be checked and the rate of interest would be higher by reason of this Levy. It is true that there is another alternative. The State might elect to provide Capital for industry, but this would mean that it would have to raise it by taxation, either open or disguised. The latter would arise, if the Government carried on industries or performed various services (such, for instance, as providing transport on the sea or by rail or possibly by air) and charged higher rates than were necessary, in order to accumulate a surplus for capital outlay. In that case, however, the method devised, to reduce taxation, would end in increasing it.

In principle and in an ideal world there is much to be said for a great redemption of debt as soon as possible—in the actual circumstances after peace there will be little or nothing in its favour outside a severely limited sinking fund. The extravagance of our war finance has been notorious, and until it has experienced a radical reformation, the magnitude of the debt constitutes a certain check and an incentive towards public economy. Almost all writers upon public finance unite in deploring the tendency towards free spending of public funds by Government Departments. The press of a time of war and the creation of great numbers of officials have made extravagance inevitable. Further, it may be questioned whether a certain amount of responsibility does not rest upon the whole community. Even in time of war, an economical people will not permit waste of public funds. During more than three years of war, there has been no effective pressure towards economy in expenditure. It was only in the summer of 1917 that the Select Committee upon National Expenditure was constituted. It may be that the apparent apathy of the nation resulted from other causes. It has given its wealth for the prosecution of the war generously and with both hands, but the public have noticed with regret and pain that the fruits of its parsimony have been lavished with reckless profusion by successive Governments. If a future Parliament should come, like the plausible spendthrift,

asking for further sacrifices to reduce its debts, it is only ordinary prudence to demand proof of amendment by the test of experience. Until that time comes, the harassed taxpayer has a certain amount of protection in the magnitude of the debt and the consequent high taxation which it involves. There is a limit to the taxable capacity of the country, and that, in the last resort, is a safeguard against the extravagance of public expenditure. In my judgment the taxpayers of the country would be well advised to resist any large repayment of debt until the State has shown convincing proofs that it has begun to practise again the elementary duty of economy in public expenditure.

I regret that much of what has been said in the present lecture is necessarily negative, though some conclusions of a positive character may be developed from it. To a large extent it represents a clearing of the ground for an investigation of the future financial position, as far as that can be foreseen at the present time. There is no special merit either in taxes upon capital or upon income, since in special circumstances either may tend to transmute itself into the other. Every proposed system of taxation must be investigated upon its merits and in relation to possible alternatives. The various methods of Conscription of Wealth or Capital Levies which have been discussed appear to be open to serious objection upon the ground either of dangerous consequences or in a failure of equity. In devising a system of taxation for the period after the war, special care must be taken that owners of wealth or capital, as the case may be, will not feel that they have been proscribed. Proscription of wealth is as much to be avoided as industrial conscription.

THE PERIOD OF FINANCIAL  
TRANSITION

You know,  
Our sad condition  
Was partly owing to  
The quick transition  
From war to peace.

WILLIAM HONE.

## THE PERIOD OF FINANCIAL TRANSITION

MANY discussions concerning the finances after the war proceed upon the tacit assumption that, when peace is signed, a normal financial system will be re-established. This impression is shown to be misleading, merely by being made explicit. The cessation of hostilities cannot end all the expenses of war, since time must elapse before the Army can be brought home and demobilised. Many other kinds of outlay will continue, though at a rapidly declining rate; so that, even after peace, expenditure will be comparatively high for a considerable period. On the other hand, the revenue will probably be subject to considerable fluctuation. Special war taxes, such as Excess Profits Duty, may be remitted. If there is a fall in prices, it would seem that there may be a reduction in profits with a decline in assessments for income tax. As against this there will be new incomes subjected to tax, as the soldiers are demobilised, and they return to the businesses they left in order to undertake military service. It follows that there will be a fairly well marked period of financial transition, which will begin when peace is re-established, continuing during the demobilisation of the forces and probably extending beyond the latter date. During this interval of transition the foundations of the financial system which will prevail in the succeeding five or ten years should be laid; and, accordingly, it is important to analyse the general character of the transition and also to attempt to determine the space of time over which it may be expected to extend.

There are two aspects of demobilisation—the one that of the Army, which is concerned with the time at which soldiers can be liberated from military service as well as the provision of

transport in order to return them from overseas service, and the other that of the Ministry of Reconstruction which is charged with arrangements for facilitating the settling of the men in productive work. The first of these is more important from the point of view of expenditure, and the second will acquire prominence later from that of the revenue. A rapid demobilisation would quickly reduce the portion of the outlay upon the Army which consists of pay and the cost of equipment and rations. No period can be placed upon the process of demobilisation until the terms of peace, which will be made, are known. Military reasons might require the retaining of a considerable number of troops under arms for a comparatively protracted period. But there will be a large balance to be returned to their homes as soon as transport is available. It follows that, for the greater part of the over-seas forces, the time taken in demobilisation will be determined by the supply of shipping which will then be available for this purpose. When account is taken of the great distances which very large bodies of men must be transported, it becomes clear that the process will extend over a considerable time. British troops in distant theatres of war must be brought home, while the Canadian, Australian, New Zealand, South African and American forces will require to be carried to their own countries. While the total period of demobilisation may be comparatively protracted, it has to be noticed that the Armies at home can be demobilised almost at once; and, as each group of men is returned from over-seas, they will cease to draw rations, as also Army pay, soon afterwards. But a more important and a quicker reduction will be in the winding up of the Ministry of Munitions. The great need for an increased production of the appliances of war, which called it into strenuous life, will have ceased when peace has been proclaimed, and as soon as possible the manufacture of guns and shells in new national and controlled factories will be ended. Within a few weeks by far the larger part of the outlay upon this Department will have been concluded. This will result in a great reduction of expenditure. Up to September 1917 the Ministry of Munitions had disbursed over 1,000 millions since its



inception<sup>1</sup>. This constitutes approximately one quarter of our total expenditure during that period; or, if loans to Dominions and Allies be omitted, rather over one-third of the balance for the same period. While there will be a great reduction in the outlay of this Department, there will be inevitable delay before it comes to an end. An enterprise, which has grown to such a vast size and which has so many ramifications, cannot be wound up immediately. While manufacturing will cease when peace has been established, there will remain great quantities of materials and stores. A staff must be retained in order that these may be disposed of to the best advantage. Also there will be much valuable machinery which must be cared for until the time comes when it can be placed upon the market. From the point of view of administration, it may happen that, at this stage, the work will be transferred to the Ministry of Reconstruction; but, as regards finance, it is clear that the expense of the officials and workers must be met; and, until the plant and materials are sold, a temporary charge will remain.

In addition to the demobilisation of the forces, there will be a second demobilisation namely that of the army of officials which has been called into existence by the needs of the war. Some of these services can be dispensed with at an early stage. The Ministry of Blockade, the War Trade and Propaganda Departments would naturally come to an end at an early date. Many of the extensions of other Government Departments, which came into existence to meet war needs, would be reduced at varying times according to the requirements in each special case. Six months after peace there should be a striking contraction, even when full allowance is made for the demand for officials in services which will have expanded once peace has been made. It appears that trade and shipping will require a certain amount of regulation for a moderate period, even when the war is over. Thus the Ministry of Shipping may be expected to be but little reduced during the first year of peace. The scarcity of many essential raw materials and of the shipping to convey those that are available will make the continuance of a

<sup>1</sup> *First Report from the Select Committee on National Expenditure*, p. vii.

certain degree of control inevitable, while that control will involve the services of staffs by which it will be exercised. On the whole, it may be inferred that the demobilisation of officials will be slower than that of the forces and that it will extend over a longer time. In the first stages very large numbers will be released from the service of the Government, but later the process of contraction will be slow. This estimate is based upon aggregates. There are many of the regular Civil Servants who have joined the Forces; and, as these men are demobilised, they will displace those who have been acting as substitutes for them. Such replacement may effect some small saving to the Exchequer, but it will not be quite in proportion to the numbers of persons for whom there will be no longer employment in Government offices.

These various considerations point to a continuance of war-expenditure at a declining rate for many months after the war is over. After the Napoleonic wars great stress was laid upon the magnitude of "winding up" expenses, but this insistence was probably designed to cloak political projects<sup>1</sup>. Under conditions of the present day the largest items of war expenditure will cease immediately, or they will soon be greatly reduced. Still, even a year after peace, there will remain outlays connected with the liquidation of war industry which, while inconsiderable as contrasted with the expenditure of 1917, will be of moment in the altered circumstances. From the side of expenditure there is no particular time at which it can be said that the financial transition will have ended, rather it will shade off into the normal period which will succeed it. In the early days of peace the transitional character will be more prominent; but, as time goes on, the return to normal conditions will become more marked. When the stage is reached at which the latter becomes the more powerful influence, it may be said that, for practical purposes, the transition will have terminated.

Subject to the inevitable uncertainty in assigning dates, the transition regarding expenditure is much more determinable than

<sup>1</sup> W. Smart, *Economic Annals of the Nineteenth Century*, 1801-20, p. 465.

that in the case of revenue. In the latter case the uncertainties are both great and many, and one is reminded of the candid confession of Galt's Micah Balwhidder "whose thoughts were just the rack of a dream without form, and driving witlessly as the smoke that mounteth up, and is lost in the airy heights of the sky<sup>1</sup>." Yet there is something which may perhaps be inferred concerning the fire which has caused the smoke, and it is this investigation which now confronts us.

The prospects of the revenue during the period of financial transition are bound up with the state of trade during that time. If it were necessary to attempt to forecast the level of profits and other income subject to tax, it is not likely that any reliable conclusions could be reached. But it is fortunate that the position may be envisaged in a different manner, namely with reference to the yield of the taxes which were in force at the end of the war, and then in relation to possible modifications of these.

According to the estimates for the financial years 1917-18 and 1918-19 the total revenue was derived from three main sources in approximately equal proportions, namely income tax and super tax, Excess Profits Duty, and thirdly all the remaining branches (including the Post Office). The Excess Profits Duty, as a tax, has undergone a number of modifications. Its real justification has been the popular feeling against "the making money out of the war." Thus the original conception was that of "a war profits tax." If, however, it had been imposed in that form, it is to be feared that it would have proved unworkable owing to the difficulty of determining what were "war profits," and also the yield would not have been considerable. For these reasons it assumed the form of a duty upon the excess over a pre-war standard of profit, but levied upon businesses, not upon the actual recipient of the income. It has frequently been objected that, in the case of a number of investments owned by the same person where some are subject to Excess Profits Duty and others yield a less income than before the war, the taxpayer is bearing a tax upon higher profits; while, as a matter of fact, his income

<sup>1</sup> John Galt, *Annals of the Parish*, for the year 1792.

may be reduced below the amount he received before the war by reason of this special impost<sup>1</sup>. This argument has been gradually losing such force as it possessed at the time this tax was introduced. The strain upon man-power and scarcity of shipping have together brought about a new situation. The productive capacity of the country was diverted as the war progressed from the less important to the more important industries. At the stage when the State concentrated labour upon "work of national importance," it was, in effect, adding to the general profit-earning capacity of these industries; and therefore, at a time when a great increase of revenue was required, it was not inequitable that those trades which, through the assistance of the State, received special advantages, whether in a greater turnover or in being supplied with materials and labour which were denied to other businesses, should be required to surrender a large proportion, or even the whole, of the increased profit which may be held to have resulted from this combination of circumstances. If this interpretation of the real justification of Excess Profits Duty be well founded, it suggests some further considerations. It might be claimed that during the early period of Reconstruction the same line of argument would hold good, but to a less degree. Licences for importing raw material and the earlier demobilisation of the more essential classes of workers will favour some industries. Thus the question arises whether Excess Profits Duty should be continued at a lower percentage and

<sup>1</sup> Suppose an investor had an income of £500 in 1913 drawn from five different sources of £100 each. In 1917-18 three of them paid no dividends, one paid £87. 10s. and, after providing for the same reserves, the remaining one could have paid him £412. 10s. The result will be that his share of profits would be the same as before the war, but through Excess Profits Duty it is reduced by one half.

	Investment 1913	Dividends in 1917 apart from Excess Profits Duty	Dividends after Excess Profits Duty
A	£100	Nil	Nil
B	100	Nil	Nil
C	100	Nil	Nil
D	100	£87 10	£87 10
E	100	412 10	162 10
	<hr/> £500	<hr/> £500 0	<hr/> £250 0

based upon standard profits for a period of years between 1910 and the end of the war. In this way the result would be secured that only firms which experienced an exceptional prosperity, which might with reasonable probability be attributed either to deferred consequences of the war or to special facilities provided by the State, would be subject to the reduced duty. At the present time it is impossible to pronounce a decided opinion upon this matter. Upon general grounds there would be many weighty arguments against such a tax. When British merchants have to enter into competition in over-seas markets, the existence of a Duty of this kind, to which some of their competitors were not liable, would constitute a most serious impediment to the regaining of our position in international trade. On the other hand, circumstances might possibly arise in which the full injury of such a tax would not be felt. If the chief foreign trading nations were compelled to continue their War Profits taxes at a reduced rate during the period of financial transition, British traders, in being liable to a similar burden, would not suffer a differential disadvantage; though it is true that they would lose a benefit in so far as, under these circumstances, our financial position might have enabled us to dispense with it and in that case they would have been advantageously situated in relation to the burden imposed by taxation upon profits. As far as can be judged this condition is not likely to be satisfied. Some neutrals and perhaps one or two belligerents, will not have had such great war expenses that they will be compelled to continue a War Profits tax, but there are other circumstances which may be more probable. In the first nine or twelve months after peace there will be most urgent demands upon many trades in all countries for the re-starting of the normal life of Europe. If that demand is in excess of the total capacities of supplying it, those firms which can get to work early will have a double element of a temporary monopoly, first in getting a start by permission of the Government in securing labour and shipping space, and secondly in so far as, owing to their being established before the war, they will have the field to themselves before competition could be developed. Should events take this turn, a continuance



of Excess Profits Duty at a reduced rate for a year or so after peace would not be inequitable<sup>1</sup>.

Then there is a special case which requires separate consideration. The encouragement of new industries, the maintenance of key industries and the economic policy which might result from the establishment of a League of Nations<sup>2</sup> may result in the favouring of certain industries by the State for a period of years. There is no reason to revise the views expressed upon the economic aspect of this policy in a lecture of the previous series<sup>3</sup>. But should the country eventually decide upon a policy of State-intervention in favour of industry by means of protective tariffs, something remains to be said from the point of view of revenue. It is a commonplace that in so far as a tariff is efficient in affording protection it produces little revenue. Also one of the great objections from the social point of view is that, sooner or later, large masses of the people feel that they are being taxed through a rise of prices, which is believed to be due to the tariff, for the benefit of private interests. It seems that the latter objection could be greatly mitigated, with advantage to the revenue, by the continuance of a special Excess Profits Duty, which would survive the transition period, upon any industries that may be protected. In the particular case of those considered essential for National safety, a certain volume of production will be required. In such circumstances it usually happens that there are wide variations in the rate of profit and that a certain amount of that variation is caused by extrinsic conditions. If a liberal standard rate of profit was established, and an Excess Duty levied at between 25 per cent. and 50 per cent. on the remainder, the public would feel that there was a considerable compensation for the higher prices caused by a tariff as affecting the industries concerned. Also such a tax would meet, to some extent, another objection, namely the

<sup>1</sup> *Final Report on Commercial and Industrial Policy after the War* [Cd. 9,035]; W. L. Hitchins, *Some Problems of Modern Industry*, 1918, p. 29.

<sup>2</sup> See above, p. 34.

<sup>3</sup> W. R. Scott, *Economic Problems*, First Series, pp. 36-39; cf. "Nationality and Cosmopolitanism" in *Scientia*.



tendency of a tariff to survive after the conditions which caused it to be imposed have passed away. The vested interest in protection would not be so attractive, when those who obtained the highest rate of profit from it were subject to differential taxation.

These considerations point to an addition to the revenue being obtainable from a survival of Excess Profits Duty in an altered form during the transition period, and, if it should happen that a tariff were instituted and a sur-tax imposed upon excess profits obtained under it, a proportion of that revenue might continue at a later stage. It may be conjectured that from these sources 30 millions a year could be obtained. But this does not exhaust the productivity of the Excess Profits Duty. When peace has been made, there will remain a very large revenue from this source still to be collected. On April 22nd, 1918, the Chancellor of the Exchequer estimated that at March 31st, 1919, and at the end of future financial years during which the war continued there would be as much as a balance of 560 millions of this tax still to be collected<sup>1</sup>. These arrears will arise in part from delay in adjusting assessments and in part from the fact that, at whatever month of the year the war comes to an end, there will remain a number of firms whose financial year has not closed and which will remain liable for the duty in the year then current. At the same time it must be noticed that this balance is subject to a liability. Under the Finance Act No. 2, 1915, Part III, persons subject to Excess Profits duty are entitled to recover losses, subsequently encountered in their business and while the duty remains in force, from the amount previously paid by them<sup>2</sup>. If this provision remains in operation at the declaration of peace, there will be a liability against the amount of duty which has not been paid in to the Exchequer at that date. Necessarily at the present time it is difficult to estimate the seriousness of this liability. Much will depend upon the extent to which there will be a dislocation of production through the cessation of war demand. To some extent, perhaps indeed to a considerable extent, the protraction of the war has resulted in a very large

<sup>1</sup> *Hansard*, 105, p. 699.

<sup>2</sup> Spicer and Pegler, *The Excess Profits Duty*, 1916, pp. 8, 9.

postponed demand for many of the products of industries which are now yielding Excess Profits duty. Therefore, to the extent to which this will be experienced, it may be expected that many of the firms producing goods of this character will avoid sustaining losses in their first financial year after peace and so they will be unable to make claims upon the sums they have already paid in this duty. The course of prices will have an effect upon the profits of many businesses, and the result of the fall which may be anticipated will be discussed below in relation to income tax and super tax; but, on the whole, the conjecture may be hazarded that, under the former head, the amount of refunds will not be very great in proportion to the total arrears.

The yield of income tax during the transition period opens up a number of fascinating uncertainties. Naturally any examination of what it may be expected to produce must begin with the income from it in the last financial year of the war. The longer hostilities continue, the larger will be the proportion of the expenditure raised from taxation; and, of the total so obtained, income tax and super tax will be prominent contributors. The chances are against peace being made in the few weeks of the year when the forthcoming Budget is prepared, so that it may be assumed that the first months of peace will be passed under a War-Budget. It is impossible to form any opinion as to whether it will be possible to effect a reduction in these taxes in the first Peace Budget. If the war does not last very long, or even if it does and at the same time the revenue from taxation is increased materially in the later stages, it may be possible to effect some small remissions of this tax. However this may be, it will be more convenient to treat the prospects of the produce of the tax during the whole of the period of financial transition as if it were levied at the rates which obtained during the last year of the war.

The influences which will govern the yield of income tax in this period will be both technical and general. In the future the method of assessment of profits on the basis of a three years' average may be modified, but there are strong reasons against effecting the change until the financial transition is completed. Accordingly, during that period, the produce of the tax will

benefit, in the case of profits, from one or two years of the war period being brought into the assessment. Then, in addition, when the Excess Profits Duty is modified or abandoned, profits above the pre-war standard, which are earned, will begin to pay income tax instead of Excess Profits duty. In actual working this will assist the revenue more than might appear at first sight, owing to the different bases of assessment for the two taxes and also, in cases where a refund is made from Excess Profits duty, through that refund being subject to income tax<sup>1</sup>. In addition the increased amount of Government and Colonial loans, upon the interest of which income tax will be collected eventually, has to be taken into account<sup>2</sup>.

The general considerations raise many questions of immense complexity, and all that is possible will be to draw attention to aspects of these which seem at present to be of most importance. For the reasons which have just been explained, the state of trade and the level of prices will be less important as affecting income tax during the financial transition than might appear at first sight. In the case of profits a decline in the amount would exert in this period less than one third of the effect that might be expected. As regards salaries a reduction in the rate, if that takes place, would be felt towards the end of the transition. On the other hand, by that time, there would be some tendency towards compensation in such earnings of officers and men, who have been demobilised, as exceeded the level of abatement.

The effect of the possibility of a serious crisis must be taken into account. Should this happen the results of former experience afford a large measure of consolation. During the seventy-one years from 1842 to 1913 the cases in which the assessments for income tax showed a decline upon that of a previous year are very few. They only amount to ten occasions over the whole

<sup>1</sup> Spicer and Pegler, *The Excess Profits Duty*, 1916, pp. 27-30.

<sup>2</sup> Owing to the payment of interest upon recent Government loans having been made without deduction of tax, there is a delay in the tax reaching the Exchequer, as compared with other loans where it is deducted at the source. Since the tax-payer must return the amount of dividend in his assessment and then be taxed, the average delay appears to be about eighteen months.

period and some of the decreases were inconsiderable. When allowance is made for changes in the principle of assessment and "comparable" assessments are contrasted, the years in which a decline is shown remain the same. Moreover in that period there were included several very serious panics, and it is remarkable that in some cases these did not suffice to effect a reduction in the assessments either in the year of the crisis or in those of the immediately succeeding years upon the figure of the year before it. This was the case with the crises of 1847, 1857, 1866, 1873 and 1890. In the present century each year has shown an increase upon its predecessor. There remain three crises which were not so serious as those already mentioned but which did effect a reduction in the assessments, though in no case to the extent of two per cent.<sup>1</sup> Taking the "comparable" totals the following results are obtained:

Crisis of 1855 Assessment of 1855-6 less than that of 1853-4 by 0.3 per cent.

Crisis of 1884 Assessment of 1886-7 less than that of 1883-4 by 1.2 per cent.

Crisis of 1893 Assessment of 1894-5 less than that of 1892-3 by 1.7 per cent.

The chief effect of crises has been to check the normal rate of increase in the growth of the assessments, and it is noticeable that where there have been small decreases these have been more than compensated for by later increases of large amount. This was remarkable in the closing years of last century, when the increase was as much as twenty per cent. in six years. The rapid increase in taxable income in the period of a decline in general prices in the sixties and again in the seventies after a previous sharp advance is both noticeable and instructive.

The mention of the effects of previous crises upon the yield of income tax is not to be understood as an indication that one is inevitable during the time of financial transition. It is true that the termination of a state of war, especially when it has followed a long period of peace, may be a pre-disposing tendency

<sup>1</sup> J. C. Stamp, *British Incomes*, 1917, pp. 318-19.

towards a disturbance, but in a lecture of the previous course<sup>1</sup> reasons were adduced which pointed to the conclusion that this was not be regarded as inevitable. Rather if speculation is not allowed to get out of hand and if credit is used with judgment, being neither too constricted nor too liberal, there are good grounds for hoping that a crisis will be avoided.

In so far as the Government can exercise control upon prices through the currency it would probably be desirable on the whole that the fall, which must come, should not be too rapid. It will only be when peace has almost been won that it will be possible to say whether there will be any danger of a collapse of prices. During the latter part of 1917 and the early months of the present year, the scarcity of things in this market and Governmental action in fixing prices were in my judgment rather more important in determining the general level than purely monetary causes. The scarcity of things will continue for some time after the termination of hostilities. But there seems reason to believe that goods will then find an easier entrance into the British market than during the later part of the war. Before the end of 1918 it is to be hoped that British Shipping may be expected to increase, while it is probable that the United States, and perhaps some neutrals, will own a considerably larger tonnage than before the war. If it be assumed that, when peace is declared the tonnage Great Britain can use for all purposes will be no more than that available at present, it will certainly carry more imports. Some auxiliary cruisers will be refitted and returned to their original uses, while the termination of the convoy system, as well as delays for diverted routes and for examination, will make the same tonnage very much more efficient<sup>2</sup>. Also the flow of traffic will be changed. During the war ships from the United States and the Dominions came to Europe bringing men and supplies for the forces and returned either empty or lightly laden. When demobilisation begins, tonnage can be more fully employed by conveying soldiers to their homes and returning laden with food and raw materials from the Dominions and

<sup>1</sup> W. R. Scott, *Economic Problems*, First Series, pp. 69, 76.

<sup>2</sup> T. Tooke, *History of Prices*, 1838, II. p. 12.



the United States. Hence it follows that, while transport will not be adequate at first, it will be possible to use it to considerably better advantage and this will be an important factor in the supplying of the British market.

Another general consideration which may re-act upon the revenue would be a depression following a severe and protracted struggle. Many anticipate this contingency upon the analogy of the period after the Napoleonic wars. In the judgment of Tooke the distress from 1814 to 1816 was caused by the reaction from speculation and by the seasons. As already shown the first may be avoided and the latter is less important now than a century ago. If the rebound from the anxiety of war conditions can be disciplined and controlled, there is no great reason to anticipate such a disturbance as would effect any material reduction in the income from taxation. An examination of the indications available points to the conclusion that care and caution will be required, while pessimism, based on a faulty analogy, is to be deprecated. Rather the words of a character in an old play may be recalled as probably more apposite:

Pray, forbear  
And search not thus into eventful time  
For ills to come<sup>1</sup>.

There remains another section of the revenue, comprising Customs, Excise, Estate Duty, minor branches and the Post Office. Several of these depend for their yield upon the state of trade, and the various influences, already discussed, will apply here also. The improvement of communication and the gradual withdrawal of orders limiting the consumption of dutiable articles should be in favour of an improvement in the receipts from Customs. This influence is subject to counter-action by a fall in wages, but that may be expected to be accompanied by a reduction of prices so that the spending power of the working classes as a whole upon these articles may not be greatly checked. Indeed it is likely to be reinforced first by the disbursement of arrears of pay by soldiers as they are demobilised and

<sup>1</sup> W. Whitehead, *The Roman Father*, III. 1.



later by their wages when they will have returned to civil employment in so far as they do not displace those workers who were engaged to make good the deficiency of labour during the war.

Excise will occupy a peculiar position. In 1915-16 it produced 61 millions, and in 1917-18 the estimate was for little more than half. Here again it may be anticipated that restrictions upon the production of beer and spirits will be relaxed, though they may still be retained with reference to the strength at which both may be supplied. Accordingly, the revenue will be considerably larger than that in the last year of war, and this anticipation is independent of the manner in which the trade is carried on. If the country decides for State-ownership, the resulting revenue will be derived from a Government monopoly instead of from the present category of Excise. It is significant that in the *Report of the Advisory Committee on Proposals for State Purchase of the Licensed Liquor Trade of 1916*<sup>1</sup>, very considerable stress was laid upon the financial advantages of the proposed transfer.

The question remains as to the period over which the financial transition, in the sense in which it is understood for the purposes of this enquiry, may be taken to extend. It appears that this period may be considered to be relatively complete between two and three years after the declaration of peace. It is by no means intended that by that time the financial situation will have adjusted itself upon the equilibrium of its normal post-war condition, but that the more prominent characteristics of the epoch of transition will, by then, have passed away. This interval should permit of two annual Budgets being presented at the usual time. The forces will have been reduced to the establishment of the new standing Army, and taxation upon the proceeds of the labour of the men demobilised will be reaching the Exchequer. It is to be hoped that during the transition the main principles of the future system of taxation will have been established, so that this system will begin to produce revenue during the first year after the transition. There can be no question that much patient enquiry, united with constructive thinking, will be needed. The vastly larger revenue which must be obtained

<sup>1</sup> Cd. 8283, p. 5.

will render the reconstruction of the Income Tax system (which was already overdue before the war) inevitable. If this can be accomplished in the time and fitted into its proper place in the whole system of taxation, the instrument for procuring the necessary revenue for the post-transitional period will be ready to the hand of the Chancellor of the Exchequer.

It is earnestly to be hoped that during this interval the elementary virtue of economy in public expenditure will be re-established. After the reign of war extravagance, it seems that the only hope of reform will be through "frugality being forced on the Government by the public<sup>1</sup>."

Is it possible to make a provisional summary of the liabilities and the assets of the revenue during the period of financial transition? While it would be a delusive preciseness to deal in definite figures, certain broad equivalences can be stated leaving out of consideration the question of indemnities, since such as may be obtained will be in all probability assignable by those Allies who will need them most. On the side of the liabilities, there will be the expenses of demobilisation and so much of those of reconstruction as will fall within this period. Some of the latter will involve the same principles as the outlay on demobilisation, that is they should not be paid out of loans. It would be unwise to borrow for either purpose. During the later stages of the transition there will be other demands for reconstruction which will be of a different order. These will be of a reproductive character. Though it would be advantageous that borrowing should be avoided once definite war expenditure ends, this course would be legitimate, if funds for an urgent reform, such for instance as workmen's houses, could not be provided otherwise. In the special case of a State purchase of some class of property, already in existence, upon a large scale (as for instance, railways, mines or the liquor trade) this particular question will not arise, since, from this point of view, the transaction would resolve itself into an exchange of securities—Government stock being substituted for the shares of joint stock companies or the interests of private owners.

<sup>1</sup> W. L. Sargent, *Apology for Sinking Funds*, 1868, p. iii.

The financial liabilities of the transition will thus be seen to be sufficiently formidable. The following will be the general nature of the assets available to meet them. Successive Chancellors of the Exchequer have accepted the principle that the continuing revenue from taxation ought to suffice to meet the cost of Civil Government and the interest on the net National Debt. In addition a beginning must be made in the reducing of the Debt. According to the information available, the balance of probability points to the total revenue from these branches of revenue being approximately maintained during the transition, if the rate of taxation is not reduced. It may be that, with an increase in the yield from taxation towards the end of the war, there may be a surplus from these branches over the charges now specified. In any case no material reduction in permanent taxation as a whole should be made in the first year of the transition, whether one would be possible in the second Budget would depend upon circumstances which cannot be estimated at present.

Assuming that the expense of Civil Government, of interest and sinking fund on the net national debt are thus provided for, there remains the expenditure on demobilisation and on the beginning of reconstruction. How is this to be met without loans, except for definitely reproductive purposes? The problem may seem insoluble, if it is not remembered that there are two important resources. One of these has already been described. It consists of the balance of Excess Profits duty which will amount to a large sum, together with any additions to it which may arise, in the manner already suggested, from modifications of that tax. The other is a concealed asset, but which will become of very great importance by the time the war ends. Out of the funds, which have already been counted as war expenditure, large sums have been used in order to provide working capital for the purchases of wheat, sugar and raw materials<sup>1</sup>. Up to September, 1917, the wheat Commission had received 67 millions from the Treasury<sup>2</sup>. These sums will return to the Exchequer as

<sup>1</sup> Hansard, *Debates, Commons*, 98, p. 1330.

<sup>2</sup> *Second Report of Committee on National Expenditure*, p. viii. In *The*

the stocks are sold off in the period of transition, subject to any loss or profit which has been made. Some of these trading transactions of the Government will yield a profit, but there will be losses to a greater amount upon others. Still if the loss is met at the time it is incurred and the profit carried forward, some benefit will be derived from the latter in the transition. Then there will be whatever is obtained for surplus army supplies as these are realised. But what will be much more important will be the sales of ships, factories and plant which have been acquired by the State during the war. The vast amount of engineering plant, purchased by the Ministry of Munitions, should be disposed of as soon as possible consistently with realising to the best advantage. The sooner it is sold, the more quickly it can be put to productive uses. While a few of the new National Factories may be retained, some, together with other war time national plants, will no doubt be disposed of, and the sums realised will be available in the period of financial transition. In addition, there will be the National Shipyards and all the shipping acquired by the State. However these will be dealt with, it is unquestionable that they constitute an asset of great value. If both are sold, which would appear to be the wiser course, the proceeds would be a great addition to the revenue. If, however, it were decided to maintain a State transport system, the ships would constitute an asset of large value, which would require to be taken into account in picturing the financial position after the war.

If it be assumed that the State-owned ships are sold, it is clear that the period of transition will be provided with a great extraordinary revenue, arising from the balance of Excess

*Economist*, April 6, 1918, it was estimated that at the end of the financial year 1917-18, recoverable expenditure, other than loans to the Allies and Dominions would amount to about 400 millions. According to the statement of the Chancellor of the Exchequer in introducing the Budget on April 22, 1918, the recoverable expenditure (after making allowance for loss on realisation) upon advances, other than loans, to the Dominions and Allies, food-stuffs, bought by the Government for resale, land securities, buildings, ships and stores of the Ministry of Munitions, at the date of the Budget, amounted to 572 millions, rising to 672 millions by March 31, 1919. At the later date it was estimated there would remain 500 millions of Excess Profits Duty to be collected.—*Hansard*, 105, pp. 698, 699.

Profits duty, perhaps from modifications of that duty which will be continued, from sales of Government property and ships. Some of these assets will almost certainly be increased before the war ends, so that the aggregate proceeds will be very large. In the circumstances, it is impossible to make any estimate even within wide limits, but it would be surprising if this source of revenue did not suffice not only to meet the cost of demobilisation, but also to leave a surplus. If a surplus were secured, it might be allocated, for purposes of calculation, to the credit of a suspense account to meet any cases where an Ally, which has been hard pressed during the war, is unable to pay interest, at first, upon the sums borrowed from Great Britain<sup>1</sup>. It is possible that during the period of financial transition there may be doubt in a few cases if these obligations can be met, and so the value of such loans will be uncertain. For the purposes of certain calculations to be made in the next lecture, it will be convenient to be able to rely upon the amount of interest which will actually be paid upon loans made to the Dominions and Allies. This method to a large extent will meet the difficulty. If eventually, as is to be hoped, interest will be paid upon the whole of this debt, then the sums, allocated as a suspense account in this form of statement, will be available for the extinction of debt.

If a proposal, which is at present being debated in France, were carried into effect the debt charge would be lower than that upon which the foregoing calculation is based. The French scheme is to add a fourth unity, namely that of finance to the united cause, the united front and the united command. It is proposed that all allied expenses should be aggregated and that interest should be divided amongst the nations in proportion to their national incomes. The effect would be to afford a great relief to France at the expense of the United States. Great Britain would gain to an appreciable extent. Professor Gide has calculated that, upon the assumption that the war lasts till the

<sup>1</sup> The same general effect would be secured even if the ships were not sold, but were worked as a Governmental enterprise. The income derived from such operations would be available to meet the interest which was not forthcoming from an Ally.

end of 1918, this plan would reduce the charge on the British debt by 20 per cent.<sup>1</sup>

This scheme is interesting and suggestive; but, at the present stage, it has not been sufficiently developed to afford a basis for calculation. It may suffice to say that, if it were adopted, the substitution of a proportionate debt for a net debt would effect a substantial reduction in the charge for interest and sinking fund.

<sup>1</sup> C. Gide, *Des Projects d'Entente Financière*, 1918, p. 3.



TEN YEARS AFTER

Restraints laid by a people on itself are sacrifices made to liberty ;  
and it never exerts a more beneficent or a greater power than in  
imposing them.

W. SAVAGE LANDOR.

## TEN YEARS AFTER

THE conclusions of the previous lecture constitute the point of departure for the final stage of the enquiry. It was inferred that the period of financial transition would last for between two and three years after the declaration of peace. Provided there will be no great reduction in the revenue through remissions of permanent taxation at this stage, it was proved that there were ample resources in sight to meet the liabilities of that time. While it is in progress, it may be anticipated, that the foundations of the system of taxation which will be required in order to meet the tremendous burden that the nation must bear, will have been elaborated. Possibly that system may be sufficiently advanced to be used to some extent in the last Budget of the transition, and it should be more fully established in the first Budget of the ensuing period. The simplification of Income Tax should be completed by this date with the result that it will be primarily more productive, and also more equitable. The details of a method of taxation, which were tolerable when this tax was low, became a real hardship when the rate was increased by more than 500 per cent. Many anomalies had been recognised and were awaiting consideration in the years immediately before the war; and, even during hostilities, these became accentuated by the increase in the tax. A smooth graduation of the tax, by which the "jumps" at certain points which were characteristic of the early war period may be avoided, will be necessary. On the one side it will be graduated more steeply in order to bring the larger incomes more heavily under contribution; while, at the other end, it may be considered necessary to lower the limit of exemption; provided, in the new system of taxation, the total burden upon the more necessary commodities is not increased. The latter involves in the words of Dr Marshall "inverse graduation"

upon those classes with small incomes<sup>1</sup>, that is to say, indirect taxes upon the commodities they consume will be felt by them to a disproportionate degree. Accordingly the limit of exemption is closely related to the taxation of commodities, and it also is relative to the level of general prices. An exceedingly steep graduation, which may take in income tax as much as two-thirds of the largest incomes, must, upon the conditions indicated but not otherwise, be balanced by a low rate of exemption. As the tax on the higher incomes rises and as it may extend further downwards, the progression will tend towards an increase upon the intermediate incomes. Thus there is contemplated an income tax which with the addition of super tax<sup>2</sup>, starts at a low level and rises gradually and progressively with each increment of income. In the circumstances it must inevitably fall very heavily upon the largest incomes, indeed to an extent which can only be justified by great financial pressure. Almost any graduation that starts from a low income of perhaps £100 a year on an average and proceeds onwards progressively, must take a very large proportion from the greatest incomes, if it is to raise a sufficient revenue.

Extension of the tax and an increase in its rate must be related to the nature of the abatement allowed. It is possible that more attention will be paid to the circumstances of the taxpayer as regards the necessary claims upon him. The system of abatement, which was in force before the war, was based on wide averages. It favoured the tax payer who could claim it and at the same time had no dependents. It seemed to prejudice another who had a large family. It may be possible to classify abatements so as to recognise varying domestic conditions, making additional allowances for the married man and further abatements for children and other dependents. A decrease in the limit of exemption would make such a course almost inevit-

<sup>1</sup> *After War Problems*, pp. 326, 327.

<sup>2</sup> The scale of progression, which is contemplated, would advance from the least income taxed up to the highest. It is a matter of convenience whether, after a certain point, the tax on larger incomes is collected as income tax or is divided into income tax and super tax, provided in the latter case that the progression is applied to both.

able. But the proposal is not so simple as it appears at first sight, and it raises two interesting theoretical considerations. Whatever income be selected for purposes of exemption the bachelor, who has no dependents, has a larger surplus upon which taxation can be levied than the married man with young children whose income is the same. So it would seem to follow that, for all incomes whatever the amount, an abatement for marriage and for children should be allowed. But this conclusion comes into conflict with another principle of a different nature. Progressive taxation is founded upon the conception that the enjoyment obtainable from the use of an income does not increase as rapidly as the income increases. Therefore the taking in taxation of larger proportionate sums from the larger income does not in general involve as great sacrifice by the recipients of those incomes as if an equal sum were collected from the same income which was divided amongst several taxpayers. Thus progressive taxation is closely related to the estimation of utility derived from income. But the suggested abatements for a family are traceable to the purely objective principle of "ability" of the taxpayer. In terms of utility, on the average, the happiness arising through wife and children is universally recognised as beyond price, and so it follows that the father of a family is asking to be relieved of taxation on the ground of a loss of utility while, on the contrary, he has, upon the average, gained in utility. It follows then that progressive taxation, together with universal abatements upon the ground of family responsibilities, cannot be justified. Either may be maintained as parts of alternative systems of taxation, but not both together, unless progressive taxation can be supported on other grounds than the principle of Diminishing Utility. But, while universal abatements for family responsibilities cannot be established as part of a scheme of progressive Income Tax, they may perhaps be applied in relation to the smaller incomes. In this case it is in the interest of the State that the citizen should not be prevented by taxation from rearing a healthy family. Accordingly, if the limit of exemption is fixed at a flat rate, without taking account of marriage or dependents, that limit must be placed at the

amount in which the family is regarded as the unit. This is in fact presenting a bonus to the unmarried. If, on the other hand, in these incomes extra allowances were made where the taxpayer was married and supported his wife and also for each dependent, the limit of exemption would then apply primarily to the unmarried who were without dependents. In that case it might be reduced, upon the principle that the income exempt from tax was just that amount which was necessary for the support of anyone upon whom no one was dependent<sup>1</sup>.

The same line of thought applies to a class of cases which has been subject to some discussion of late. This is the apparent anomaly that if two persons, who have each an unearned income, should marry they at once become liable to higher income tax than if they lived together without the marriage ceremony. In terms of utility there can be no doubt that there is a heavy burden of disadvantage upon those who form an irregular union. Amongst the many causes of such unions it would be futile to pretend that any appreciable number of persons have contracted them through the dread of paying a higher rate of Income Tax. Probably there is no one who has seriously entered into an irregular relationship in order to evade tax. In any case, a slight extension of the present special abatements on the ground of marriage and dependent children to persons with small incomes would meet the objection, if at the same time the limit of exemption were made applicable to those who had no immediate financial responsibilities for others.

An income tax improved, graduated more precisely and perhaps extended downwards would be highly productive, but it would still be subject to one great defect. It would not discriminate between income which was saved and that which was expended in ways which may be wasteful or even hurtful. *Luxuria saevior armis* is a saying that will apply with particular force in the generation after peace has been made. Attention has already

<sup>1</sup> According as the State relieves the taxpayer of financial responsibility regarding his family (as for instance by providing free education, meals for school children, or "endowment of motherhood") so far these abatements would be reduced.



been drawn to the most urgent need for accumulation of capital in order to provide the instruments for the great production which will be required<sup>1</sup>. It is true that the repercussion of war is tending to provide for a considerable increase in saving; but, to some extent as taxation falls with increasing weight upon the higher incomes, it will cut into the surplus from which savings have normally been made. Accordingly, if it were possible, it would be desirable that taxation should also differentiate against luxurious or extravagant expenditure and in favour of saving. Unfortunately, beyond the limited scope of taxes upon luxuries, sumptuary legislation has always been unsuccessful. It is to be noticed that the existing Income Tax is concerned primarily with income as a whole; while, in recent years there has been a tendency to give consideration to the source from which the income is drawn and to some extent, in the case of small incomes, to the claims upon it. To favour savings would be to go a step further in a direction which was strongly advocated by Mill, who said that "no income tax is really just from which savings are not exempted<sup>2</sup>," but hitherto practical difficulties, as well as the rapid accumulation of capital during the second half of last century, have prevented any material changes in this direction. The claim for the favouring of savings or (what tends to be the same thing) the discriminating against extravagant uses of income will be based on other grounds than those of equity. As far as the future in the next generation can be foreseen, it appears that there will be a national advantage in increased saving as compared with that before the war, while such saving may be more difficult. As yet no comprehensive plan for encouraging saving by means of income tax exemption has been devised which seems likely to be satisfactory, but the problem may be approached from the other side by discrimination against the expenditure of that surplus of income from which savings could be made. Long ago Mill favoured a graduated house duty as a tax upon expenditure, since the annual value of the house occupied was in general considered to be a rough

<sup>1</sup> W. R. Scott, *Economic Problems*, First Series, pp. 94, 95.

<sup>2</sup> J. S. Mill, *Principles*, v. II, § 4.

measure of the expenditure of the person who uses it. It may be questioned whether this is as true now as it was when Mill wrote. Before the war improved facilities for travel, and in addition the use of motor cars, have produced larger inequalities between the annual value of a particular class of house and the total expenditure of those who occupied that type of dwelling. Still, in spite of obvious defects, an increased graduation of the pre-war house tax, is deserving of consideration. For purposes of this tax the annual value of several houses in the occupation of the same person should be aggregated, so as to bring the total under the higher rate of duty. In the scarcity of housing there is a certain element of monopoly in one family reserving for its own use in a number of houses perhaps five times its maximum demand for accommodation and much more than that as contrasted with its average requirements. The hardship, which would result to some wealthy persons, should be considerably minimised by the discovery which so many have made during the war, namely, that it is possible to live with as much or even greater comfort by contracting their demand for house accommodation, as for instance when one of a number of country houses owned by the same person has been devoted to national purposes or let, instead of being occupied by the family for a month or two in the year. Should a steep graduation of the House Duty be adopted, a great deal would depend upon the time at which it was brought into operation. In so far as it was effective, in restricting expenditure, it would have the result—unless there was a substantial increase in the incomes of the richer classes—in a general movement downwards into houses of lower annual value. Therefore it should not be introduced too early (since otherwise there would be an additional pressure upon some classes of houses with, perhaps, a great temporary scarcity); nor yet too late, since once the arrears of building have been overtaken, and contractors are looking for new work, it would be important that they should be able to anticipate any alteration in the demand for particular classes of houses which would result from the change that might be made in this tax.

In several respects Estate Duty is closely related to the im-

posts which have just been discussed. If this duty were considered in isolation from the remainder of the system of taxation a comparatively strong case would exist for a large increase in the rate. From that point of view it seems that, on the whole, the war will have the effect of lightening the burden of the duty for a number of years after peace, as long as the rate remains unchanged. This unexpected result arises from the fact that the greater part of estates, passing at death, are held for income by the recipients, and are not turned into commodities. In the latter case, on the assumption that prices for ten years after the war will fall but will remain higher than in 1913, it follows that a bequest turned into commodities will have less purchasing power than formerly. This is much the rarer case, and where the heirs retain the securities they inherit (or acquire other securities of equivalent value) they gain while the rate of duty remains the same, because, on the average, prices of first class securities will be lower during the early years of peace than they were during a corresponding period before the war. Since this duty is assessed upon the capital value, the lower price of stocks will cause the duty to be less, hence the same income can be inherited with a lower charge for Estate Duty than before the war<sup>1</sup>. This, however, is only one side of the case. It has also to be considered in relation to the part of the tax system which has been already outlined. In that system the suggested large

<sup>1</sup> Strictly speaking this applies to Estates not exceeding £60,000. Early in the war the rate of duty on those of £60,000 and over was increased. The working of the principle suggested in the text may be illustrated as follows in cases where the duty remains unchanged. In the case of an Estate valued at £20,000, which for simplicity may be taken to pass to one person and the investments remain unchanged, it may be supposed that it was invested in 4 per cent. stocks which, before the war, were quoted at par. If that Estate passed by death, say in 1913, the duty would have been £1,200. In 1917 its value would have been only £16,000. It is improbable that stocks of this class will average pre-war prices during the first ten years of peace. Let it be assumed that in that period they may average 90, that is a price mid-way between the war-price and the pre-war price. Then the value of the Estate for purposes of Estate Duty would be £18,000, and, in that case, the duty would be £900, since the total is less and the rate falls from 6 per cent. to 5 per cent. Thus, while the income would be the same, the beneficiary in this particular case would benefit by £300 in duty, or as much as 25 per cent.

progression in income tax would add materially to the burden of the wealthy, and so it will make it more difficult for them to save. In so far as the desire to provide for children is an exceedingly powerful incentive towards accumulation, to that extent a high and progressive Income Tax united with large graduated Death Duties would act as a dangerous check upon saving just at the time that this form of self-denial was most required. Accordingly it may be concluded that, if Income Tax is made sufficiently progressive, no material increase in the rate of Estate Duties would be judicious. It is true there is an alternative. It may seem to some that the line of least resistance would be to rely upon augmented Estate Duties rather than upon an increase of Income Tax upon high incomes. It is probable that the latter method would be more productive of revenue, and its psychological effect, as regards saving, would be less unfavourable. As yet there are no data for calculating what are the effects of super tax or a steep progressive Income Tax upon the desire for accumulation. No doubt it would differ amongst different persons. It is those, who look ahead and are self-denying, who form the saving classes; and it is precisely these who feel a diminution of their capital through action of the Government most, and resent it greatly. Since a high progressive tax upon income cannot co-exist with high Estate Duties, it appears that of the alternative increases upon the rates of 1917-18, the balance of advantage, from the point of view of avoiding as far as possible the checking of accumulation, would rest with taxation of income<sup>1</sup>. There remains another

<sup>1</sup> The testator who saves for his heir, would be right in assuming that extra taxation would be more advantageous from the point of view of his successors if levied on income rather than on the capital. Suppose that, under a progressive scale of income tax, the tax on a very large income was 60 per cent. and the alternative was an Estate Duty of 50 per cent. The recipient of the income would probably consider it was worth saving, since (at 5 per cent.) he would still receive 2 per cent. clear of tax. If it be assumed that the particular beneficiary was liable to income tax at 20 per cent. in the former case he would receive the full value of the investment subject to a duty of say 20 per cent., which is the present rate. That after deducting his own income tax would yield him  $3\frac{1}{2}$  per cent.; whereas, with a 50 per cent. Estate Duty and on similar conditions, the yield to him would be reduced to only 2 per cent.

possibility, instead of endeavouring to secure the main increase in direct taxation from one of these sources, that increase might be obtained from both. Instead of a steep graduation of *either* Income Tax (including Super Tax) or of Estate Duties, a less graduation might be applied to each. There would be some slight advantage to the Revenue in relying more upon taxes upon income, while what slender indications are available point, though somewhat uncertainly, to the taxpayers having a preference for these rather than the corresponding Death Duties.

These seem to comprise the more important matters, which are ripe for discussion at the present stage, in relation to the chief direct taxes. There remain the indirect taxes. In a recent work Dr Marshall has said, very judiciously, all that is necessary about these<sup>1</sup>. It is there shown that "the war has developed a new political situation,...and it has forced even those, whose detestation of war is the most intense, to recognise that industry and trade can no longer be regarded only as hand-maids of life; for they are likely to be used by a strong military Power as pioneers of destruction and death. It may therefore be right to take some measures, which are not appropriate to ordinary conditions, in order to lessen the ability of a determined enemy to destroy." Such a balanced judgment is far removed from some of the wilder incitements to an "economic war after the war" which was condemned long ago by Thackeray, when he satirized somewhat similar demands of his own time—"Block the harbours for ever; destroy the inlets of Commerce of the world; perish cities so that we may wreck an injury on them. It is the talk of madmen, but none the less wicked<sup>2</sup>." The maintenance of "key" industries or those deemed necessary for the safety of the country may require some measure of intervention by the State, though, as regards the former, the country in a few years may be in danger of acting as many individuals do, namely, preserving carefully the keys after the locks have been lost! Further it is to be taken into account that (as has

<sup>1</sup> *After the War Problems*, pp. 326-345.

<sup>2</sup> Thackeray, *Roundabout Papers—On Half a Loaf*.



already been shown<sup>1</sup>) some forms of the economic action of the proposed League of Nations may require either temporary or permanent tariff arrangements. From the point of view of the present enquiry it is more significant that any scheme of moderate duties, should such be established, would not be productive of a considerable revenue, as this will require to be interpreted in view of the financial demands of the future. Such additions to the taxation of commodities as may be made will be directed to political and social ends, and therefore they will succeed precisely to the extent that they are non-productive of income to the Exchequer.

In addition to those taxes, both direct and indirect, which were in force in the financial year 1917-18, others no doubt will be added. Amongst the many instruments which will be employed in the era of Reconstruction, taxation will no doubt find a place, either directly to check forms of activity which are deemed disadvantageous in the new circumstances or indirectly in order to provide revenue with which to pay the subventions which may be granted to encourage some useful development. Here it must be observed that, as larger proportions of the national dividend are taken in taxation, the new imposts become the more subject to objection. As a rule the less disadvantageous taxes are imposed first; and, as it becomes necessary either to augment the rates of existing taxes or to add new ones, the burden of disability involved tends in general to increase. Conversely, even though the revenue from taxes, new or old, is augmented and at the same time the income of the people has grown more than in proportion, the total burden, in general, may not be added to. The demands upon man-power during the war precluded the establishment of some new duties which seemed promising to the Chancellor of the Exchequer<sup>2</sup>. As a rule, where expenditure by individuals has the effect of accomplishing its object in relation to similar expenditure by other persons, a proportionate tax upon all such expenditure would leave the relative position of all the same as before. In so far as any outlay, which has for its object display or social pre-eminence, could be reached

<sup>1</sup> See above, p. 34.

<sup>2</sup> *Hansard*, 93, p. 379.



by taxation, proportionate duties would leave the persons affected by them in the same state as regards each other. Taxes of this type, if practicable, could be paid with the least possible sacrifice by those subject to them and with no loss to the remainder of the community, even in some cases the result would be a gain. The case of men servants in livery, if these men are in existence after the war, may serve as an illustration<sup>1</sup>. Another instance, though here there are some obstacles, would be a tax upon the larger displayed advertisements. Small announcements of wants would be free of this tax, but large posters and corresponding spaces in newspapers and magazines would be charged in proportion to size. The new French Budget law has made wide use of this principle. Commodities of the nature of luxuries are divided into two classes. One of these consists of articles which are luxuries under all circumstances such for instance as diamonds, pearls, jewellery of gold and platinum. The other comprises goods of the nature of dress or furniture, expenditure on which becomes extravagant when the price paid for an article exceeds a certain amount. Then there is a group of conditional luxuries (e.g., motor cars as used for pleasure and not for professional and business purposes). The tax is 10 per cent. *ad valorem* on the full value of the first, at the same rate on the excess upon the permitted minimum of the second. The remaining group pays on the full value for luxurious uses but it is exempted for necessary ones. Such a system will no doubt have some of the disadvantages of Excises on many commodities, but its working may prove suggestive if taxation at the source, by means of a developed income tax, fails in checking certain forms of profuse expenditure.

The same financial pressure would justify increases in the amount of a number of fees and licences. Stamps can be made to yield more. Readjustments in the charges of the postal, telegraphic and telephonic services may be made productive of a larger net revenue. The State should aim at covering the cost of production (including interest upon capital) of any service

<sup>1</sup> Dr Marshall suggests a steeply graduated tax upon servants and particularly high in the case of male servants. *After the War Problems*, p. 325.

which it renders. After the close of the period of financial transition it may be anticipated that the heading of "Miscellaneous Revenue" will contract. Upon the form of statement, which is adopted here, it is only necessary to take into account any net revenue accruing from new State-services. In the first ten years of peace, that net revenue, should such services be established, would be small. In the aggregate it is possible that the balance might be upon the side of expenditure rather than of revenue.

In a system of taxation, such as has been outlined, the main weight is thrown upon an Income Tax which is sufficiently progressive. It must be frankly admitted that, if the graduation becomes very steep as affecting the largest incomes, it will be a disagreeable necessity. But in comparison with other methods of securing the same revenue, on the whole, the balance of disadvantage will be less. Increases in existing taxes upon luxuries (as contrasted with the rates in force in 1917) or altogether new duties will be useful in providing further revenue.

Owing to the prominence assigned to Income Tax, the circumstances which affect its yield at any given rate may be taken as generally symptomatic of the produce of most of the remaining taxes. Therefore it may be sufficient to restrict attention to such influences as may be expected to affect the income from this source. It has already been shown that the revenue from Income Tax during the period of financial transition need not occasion anxiety<sup>1</sup>. It will be aided, as regards profits, by the inclusion of the final war years when business should remain good. Through the exigencies of the work of restoration, upon the three years average, the first two or three years of peace should still receive considerable benefit. Though debt will have continued to increase until the end of the war, the interest paid upon it will return in part to the Exchequer in the form of Income Tax. Many are of opinion that, once the urgent work of restoration has been finished, there will follow a period of dulness or even depression in trade. It would seem as if commerce and industry, after the extraordinary efforts demanded

<sup>1</sup> See above, pp. 98-100.

by war-production and the subsequent pressure in restoring war's damage, must pause for recuperation. It is true that depression in trade has followed several previous wars, but attention must be paid to a radical difference in the conditions. On many of those occasions—perhaps in most—one outstanding cause of the check to activity was the undeveloped condition of credit in former times. If the resources of modern banking and allied financial institutions are used to advantage, there appears no good reason to expect an inevitable depression. At the worst the produce of a given rate of Income Tax would, on the average, either re-act slightly or increase more slowly than normally. But in so far as it is possible to estimate numerous highly uncertain conditions, subsequent events have tended to confirm the expectation expressed in the previous course of lectures, namely that the present awakening of the nation will be productive of highly beneficial results for its industry and commerce<sup>1</sup>. The experiences of the young manhood of the country will have added greatly to the intangible, but none the less important, immaterial wealth of the country. At present the vital energy, hope and determination of the young is wanting in the facing of the future, and allowance must be made for the pessimism of the tired, the middle aged and the elderly towards coming changes. Thus there are too often apprehensions in the minds of many towards:

Things to come  
Which leave within them musings troublesome  
To their weak spirits<sup>2</sup>.

Another anxiety is the dread that high taxation will exercise a restricting influence upon trade. This is most commonly expressed with reference to the future of overseas markets. It is feared that the British merchant, burdened with heavy taxes, will compete at a disadvantage. This might be the case if he had to meet traders of other nations who would be subjected only to the lesser weight of their pre-war burdens. But one result of a world-war has been that all the chief foreign trading nations will be compelled to raise much higher revenues from taxation

<sup>1</sup> W. R. Scott, *Economic Problems*, First Series, 1917, p. 19.

<sup>2</sup> G. Withers, *A Dark Lantherne*, 1652, p. 7.

than in the past. It seems possible that in the majority of cases their merchants will be at the greater disadvantage as regards the burden of taxes they will have to bear. Certainly any system of taxation, such as that suggested above, inflicts the minimum of damage upon commerce.

On the whole the prospects of the revenue are favourable. At the end of the financial year 1917-18, the method of permanent taxation then in vogue produced a revenue which was sufficient to meet the charge of civil government upon a peace basis<sup>1</sup>, to pay interest upon the net debt and to provide for pensions and a sinking fund<sup>2</sup>. The system of taxation which has been described could be made as productive as will be required, mainly by increasing the graduation of Income Tax.

Hitherto any estimate of the liability for interest upon the net debt has been made perplexing by the extent to which portions of it may not be recoverable and there may be delay in the payment of interest. By the end of the period of financial transition this uncertainty should be removed or at least greatly diminished. The method of presentation which has been adopted in the previous lecture, namely by reserving certain concealed assets as a suspense account against such sums as will then appear doubtful and passing any surplus that remains to a sinking fund for debt redemption, leaves a clear statement of the net debt for purposes of calculation. Regarded from this point of view, it will consist of the total debt less the loans to the Dominions and the Allies upon which interest is then being paid.

<sup>1</sup> As will be shown below, it seems reasonable to expect that the necessary outlay of the peace establishment must be higher after the war than it was before it.

	Millions	Millions
<sup>2</sup> Total Revenue from taxation and State Services in		
1917-1918	...	707
Less Excess Profits Duty	...	220
		<hr/> 487
Expenditure as estimated in 1914-15	...	205
Interest and sinking fund on net War Debt (5179		
millions less 2,000 millions) at 5 per cent. and		
1 per cent. for redemption, say	...	192
Available for pensions and contingencies...	...	90
		<hr/> 487

It is probable that by the end of the war there will remain a considerable floating debt as well as short dated loans which are due for early repayment. It will be a matter of great financial judgment to select the propitious moment for a first consolidating loan. The rate of interest will certainly be lower than that paid during the later stages of the war. It may be  $4\frac{1}{2}$  per cent. or even less. The first of the 5 per cent. National War Bonds of the issue of October, 1917, will fall due for repayment on October 1st, 1922, the next series in 1924, the third series in 1927 and the earliest date for the redemption of the 5 per cent. War Loan of January, 1917, is in 1929. As each is consolidated the rate of interest will be reduced. Even in the transition period a perceptible lightening of the dead-weight charge will be experienced and five years after peace this will have become more marked.

More important than the lightening of the burden of interest, through conversion and the operation of the sinking fund, will be the tendency towards the limitation of debt in the later stages of the war. The Army has a saying that the "first three or four years of the war will be the worst," and this will certainly be true of the annual additions to the National Debt. The proportion of the total expenditure raised by taxation will increase towards the end as it did in the French Wars. In spite of expenditure being much heavier in the second half of that contest, less was borrowed than in the previous period, so that the addition to the Debt was smaller. In the present war, whatever may have been the mistakes of our finance, one error, namely that of restricting expenditure in the first years, has been avoided. No doubt there has been great and even gross extravagance, but the manifestation of this encourages the hope that, without loss of efficiency (which in the circumstances is paramount) our own net expenditure will cease to increase and perhaps decline. With an augmented revenue from taxation the additions to the net debt for equal periods in the future should be less than they have been up to the end of the financial year 1917-18.

It is recorded that, upon Lord Mansfield being asked at the



beginning of the French Revolution when it would end, he replied "It is an event without precedent, and therefore without prognostic." The present war has no precedent in its financial conditions, and as it would seem to follow that prognostication as to its consequences would be futile, if not misleading. We cannot tell the amount of debt which the war will leave behind it, nor what the rate of interest payable upon it will be when the greater part of the debt has been converted and the sinking fund is in full operation. Still less can it be determined what the expense of civil government will be nor what future expenditure upon the defence of the country will be required. At the same time, whatever the figures for these expenses will be, they will be governed by certain principles and a little can be stated about each of them. As regards the debt, it has already been shown that it is probable it will increase less rapidly in the concluding period of the war, and a method has been developed by which the amount of net debt can be stabilised for purposes of treatment. It is necessary that (as shown in the previous lecture<sup>1</sup>) the swollen civil services should be demobilised during the time of financial transition. Owing to prices for some years after the war being higher than they were before it, it is not unreasonable to calculate that the cost of the same services to the State will be somewhat higher than they were previously. There may be new services added. These may be of two kinds. Some will be of a character which will not be productive of revenue; but while some of these may be desirable, it will be of great importance that they should be more severely scrutinised from the point of view of finance than in the past and that for the first ten years they shall only be established when the need is proved to be unavoidable. Employment by the State upon productive services is of a somewhat different order. If the accounts of those services bring into the general balance sheet of the Exchequer their net balances, the salaries and wages will be shown as provided by the particular service; and, from the point of view of the present enquiry, all that need be taken into consideration will be the small surplus or deficit. In a period of financial

<sup>1</sup> See above, pp. 90-92.



stringency, it will be necessary that the latter should be avoided. The expenditure upon the Navy and the Army after the period of financial transition must be a matter of the greatest uncertainty. After the Allied ideals of a stable and enduring peace have been established, it is to be hoped that expenditure upon armaments will be reduced, but that cannot be expected to have been attained in the early years of peace. It follows that during that period a considerable increase under this head may be expected.

At the present time it is not possible to assign any precise figure to the expenditure, and the revenue required to meet it, when a normal financial *régime* has been restored. But the capacity of the country to meet the great burden it will have to bear may be demonstrated from the experience of the Napoleonic wars. It was proved by experience that the nation was able in the succeeding generations to meet the burden of the debt which remained after that struggle and to take some steps to reduce it. What, then, was the relation of that debt and the expenditure which it involved to the resources of the country at that time? It is obvious that it would be useless to compare the debt as it was after Waterloo with the "National Income" or the "National Capital" at the same time, because there are at present no data by which the corresponding amounts could be estimated for the period after this war. Accordingly it will be necessary to calculate the burden of the debt at the end of the Napoleonic wars in reference to the wealth of the country at an earlier period. The only comparable figures would be those for the income or the capital of the nation at the beginning of the two wars. There is no reliable estimate of either of these for the year 1793, but there are estimates for a few years earlier and later. The "National Income" was calculated by Giffen as having been 200 millions in 1783 and by Mulhall as 230 millions in 1800<sup>1</sup>. For the purposes of the present investigation the average of these figures may be taken, namely 215 millions, as the amount of "National Income" immediately before the outbreak

<sup>1</sup> J. C. Stamp, *British Incomes and Property*, 1916, p. 427.

of the earlier war. In 1816 the total debt was 860 millions<sup>1</sup>, that is borrowing had been pushed until it reached four times the income of the people twenty-three years before. Since the "National Income" of the United Kingdom in 1914 has been variously estimated as between 2,100 millions and 2,300 millions and if an average of 2,250 millions be taken, a net national debt of four times the income would amount to 10,000 millions<sup>2</sup>. This, however, can be regarded as no more than a first approximation. The "National Income" can only be regarded as a measure of borrowing power in so far as it affords a surplus above the cost of maintaining the population from which surplus the interest upon the debt can be obtained by means of taxation. Comparing the "National Incomes" of 1793 and 1914, and taking account of the population at the two periods as well as the change in prices, it is clear that the later income is capable of affording a surplus more than in proportion to the increase. The income of 1914 is more than ten times as great, and therefore for this reason it is capable of yielding considerably more than ten times as much in taxation. The nation was able to pay 66½ millions in taxation in 1816, and, if necessary, it could pay very much more than 665 millions after this war is over.

There is, however, another side to the question of the available borrowing power that can be exercised with safety. Income increased very rapidly during the Napoleonic wars. If it be assumed to have been 215 millions at the beginning, it had doubled before the end, advancing according to Colquhoun's estimate to 431 millions in 1812-13. After that war the rapid increase ceased. There may have been a decline during the earlier years of peace; and, comparing the estimate of National Wealth for 1822 with that of 1812-13, it appears that in the later year the earlier figure was only just repeated<sup>3</sup>. It can scarcely be expected that the "National Income" will double

<sup>1</sup> G. R. Porter, *Progress of the Nation*, 1838, § iv. p. 294.

<sup>2</sup> This calculation is confined to the finances of the United Kingdom. In estimating the total financial effort of the British peoples and their borrowing capacities, account would require to be taken of the very large aggregate of loans subscribed locally in the Dominions and in India.

<sup>3</sup> R. Giffen, *Growth of Capital*, 1889, pp. 103-105.

itself during the present war; or that, if it does, that figure will be maintained in the immediately succeeding years. There has been a greater proportionate withdrawal of men for military service in the present war than in the last great struggle. On the other hand, women have taken a larger and more efficient share than then in the production of the country. Therefore it seems reasonable to expect upon this as well as upon other grounds, that, unless this war lasts longer than now seems to be possible, the "National Income" will not have increased to the same extent when peace is made, but, at the same time, production instead of becoming stationary in terms of money (as it may have done from 1816 to 1820) will continue to expand, yielding a larger "National Income" as the source from which taxation may be drawn. Accordingly, although the round sum of 10,000 millions as representing our own debt upon which interest must be paid from taxation may be an overstatement of the sum which could be borrowed with reasonable safety in case of extreme need, it appears probable that the amount justified by resources now in sight, would be perhaps two-thirds to four-fifths of that figure<sup>1</sup>.

The treatment of this question is rendered difficult by the interaction of two distinct orders of ideas. Once debt has been contracted and until the rate of interest on the loan is reduced upon conversion, the transaction is recorded in terms of money. During that period the rate of interest will be the same however prices may vary, and the amount to be raised by taxation for this purpose will be unaltered. When, however, the point of view is changed and attention is paid to the aggregate incomes from which the taxation is to be obtained, things become more important than the money value of those things. When prices rise during war, even though production may decline, it is possible for the "National Income" to increase as expressed in money. After peace prices will fall but they cannot be expected to average the pre-war level within the period now under con-

<sup>1</sup> In the Appendix an attempt is made to present a picture of the financial position ten years after the financial transition upon the assumption that it is necessary to use the borrowing powers at present available.

sideration, and so the same real production would give a roughly proportionately smaller "National Income" after the war. If production expands sufficiently to make good the extent to which prices have fallen, then the final "National Income" of the war period will be maintained. After a possible pause it is to be hoped that the quickened spirit of the people may accomplish more than this; and, if so, the "National Income," in terms of money, will increase. Also, the fall in prices will be a material benefit to the taxpayer. What is important to him is not so much how much money is left him by the tax gatherer, but what quantity of things he can purchase with that balance. It follows that as prices fall, the real burden of the same taxes will be reduced.

While it would be aiming at a meticulous precision to endeavour to fix the amount of borrowing which could be exercised with a fair measure of safety, one result is plain, namely, that in an emergency similar to that which confronted our forefathers, it is unlikely that, when full account is taken of their resources and of ours, we shall be called upon to submit to real financial sacrifices, either during the war or after it, which will be as great as those which they endured and survived. In the field and on the sea we may perhaps hope that we have not been wholly unworthy of their great example. In the lesser task of financial endeavour, it will remain to complete the period of sacrifice by bearing the burden which the war will leave behind it as cheerfully as may be. Even when peace has been secured the greater part of the material ransom of humanity will still remain to be paid. No doubt in the future, as in the past, there will be "ignorant impatience" of post war taxation<sup>1</sup>. This can be mitigated

<sup>1</sup> W. Smart, *Economic Annals of the Nineteenth Century*, 1801-20, p. 469. An instance of the impatience alluded to in the text may be quoted from a rare periodical publication called *The Black Dwarf*. It occurs in a Letter to the Yellow Bronze of Japan, dated May 25th, 1819. "My good friend John Bull has played the silly spendthrift so long, that it is not easy to remove his bad habits. What he has done he thinks a sufficient reason for what he does, or what he may do. Accustomed to pay, he habitually feels in his pocket for his cash; and, when he finds none, he is much distressed at his inability, but never thinks about enquiring if the debt is really due. All his personal property and ready money is now gone and a set of impudent

in part by an equitable distribution of the inevitable sacrifice in some such manner as that which has been detailed. Much of the feelings of injury, and even of wrong, which remained amongst many classes of taxpayers early in the nineteenth century is to be attributed more to the inequalities of the fiscal system of those times than to the magnitude of the aggregate amount in relation to the available resources of the country—great as that undoubtedly was. It will be possible to achieve substantial justice in distributing the load to be borne, and thereby the sense of weight will be lessened. As was said by Dion Chrysostom when all join in paying their share of war taxes, the burden of each is lightly borne<sup>1</sup>. The apportioning of sacrifice, justly and at the same time with the least disadvantage to commerce and to social needs, will occupy much of the attention of students of public finance in the future. But there will be another aspect of finance which will be no less important and which is much wider in its scope. The liability imposed by the war upon future generations of taxpayers, might be described as fixed in its initial stages but with an undetermined fringe. At least half of it will consist of interest upon the debt and sinking fund, pensions, too will remain to be met, though later these will decrease, automatically. Much of the peace expenditure is unavoidable. All these items together will constitute a definite amount which will vary little in the earlier years of peace. But the source from which taxation will be drawn to meet this liability may be augmented by increased and more effective Production. In order to meet that part of the cost of war, which has been borrowed, a larger and a more efficient output of Wealth will distribute approximately

varlets...now tell him that his real property, lands, houses and all is mortgaged to the fundholders for upwards of eight hundred millions of money advanced and spent in his service. John says he is now in a much worse condition than he ever was before and that his pockets have been emptied of a thousand millions more in the shape of taxation besides the tythes and the poor rates and the country rates and the devil rates besides which have rated him out of all reason and out of all means of subsistence to boot. When John talks in this way they tell him he is mad. But if oppression maketh even a wise man mad, what is to be expected from revenge and oppression to boot operating upon a mind not more than usually strong?"

<sup>1</sup> "Όταν γὰρ ἐξ ἀπάντων συνεισφέρηται, ἐκάστῳ κοῦφον γίνεται τὸ ἐπίταγμα.



the same burden of taxation over a greater "National Income" with the result that the sacrifice upon each unit of that enlarged income will tend to be less. As the possible surplus above the maintenance of the population and the taxes to be paid grows, so the fund from which savings can be made will increase and the provision of new Capital will aid further industrial advance. In this way the ultimate financial problem at once merges itself into, and at the same time reinforces all wise schemes and all the concentration of effort for the improvement of industry and commerce in the future. And so the argument returns upon itself, and it comes back again to the point with which the opening lecture of the former course ended. Reasons were then advanced which led to the conclusion that very great developments were possible, and that there were reasonable grounds which led to the confident expectation that many of these would be realised. I may be permitted to repeat what I said upon that occasion, for the events of the past year have confirmed my anticipations—"The energising of the nation through a time of trial will result in greater efficiency when the present struggle is ended. Discoveries of new processes and methods, with improvements in old ones, will lead not only to a more productive industry; but, it is to be hoped, also to a better industry. As the murk of the battle cloud clears, one sees the first signs of a fairer dawn in which the arts of industry, broadened and deepened and at the same time more humanely organised, can accomplish in the next generation more than even was dreamt of by the discoverers of the great Victorian era<sup>1</sup>."

<sup>1</sup> W. R. Scott, *Economic Problems*, First Series, p. 19.



## APPENDIX



## APPENDIX

### *Present Borrowing Capacity (in relation to taxable resources now available) ten years after the Period of Financial Transition.*

If it be taken that, for the reasons detailed above, the resources of the United Kingdom at present in sight would justify borrowing to the extent of about 8,000 millions for the purpose of meeting that expenditure upon which this country will be liable to pay interest when all the details of outlay are known, it may be worth indicating what the financial position would be upon this hypothesis. In the supply of men and material the present war has taxed our resources more than that at the end of the eighteenth and the beginning of the nineteenth centuries. Yet, as has been shown above, the financial drain has not yet been so great. A net national debt of 8,000 millions for us would probably not be as great a burden as that which remained after the Napoleonic wars. That would be about twice the net estimated debt<sup>1</sup> at the end of the financial year 1917-18; but upon grounds, already explained, a larger proportion of expenditure may be expected to be provided from taxation, and economy in the spending departments should be a check on the rise in the outlay on the war. A net debt of 8,000 millions appears to be a possible burden on the basis of present resources. These may increase, in which case, if necessity required it, there would be further capacities for borrowing. If, however, 8,000 millions be taken as the present limit, it seems worth endeavouring to envisage how the financial position might readjust itself ten years after the end of the period of financial transition in respect to the continuing revenue which is now actually in sight. In such a calculation the figure for the service of that debt is ascertainable within certain limits when assumptions are made as to a reasonable rate of redemption and the rate of interest. The remaining

<sup>1</sup> That is the net debt in the sense of deducting loans to the Dominions and Allies from the total debt. The term "net" in this connection is becoming ambiguous. *The Economist* uses the term "net borrowings" as the balance left after the proceeds of taxation are deducted from the total war expenditure. Also besides loans to the Dominions and Allies, there are other items of conditionally recoverable expenditure. If these also be deducted the "net debt" so reached would be smaller.

amount which it is proposed to assign to the rest of the expenditure (namely 300 millions to cover the outlay on defence, civil government and pensions) is to be understood strictly upon the principles laid down in the concluding lecture. It comprises (for purposes of comparison) the outlay on the Post Office, but it does not include that on new services which may be rendered by the Government. The latter are taken into account only to the extent that they yield a deficit or a surplus. Also the sum allocated for the expense of Civil Government is to be understood as on the present basis increased to allow for the larger population to be served. Any extensions would require to be met by further revenue secured after the war.

*Revenue and Expenditure Ten Years after the End of the Period of Financial Transition upon the various assumptions explained above.*

	mil.		mil.
Estimate of Revenue obtainable in 1918-19 (p. 63) ...	900	Expenditure on Civil Government and Defence with the addition of pensions, on the basis described in Lecture VI (p. 126) ...	300
Deduct special war taxes or war revenue ending with the war or in the Period of Transition ...	250		mil.
		Assuming a net debt at declaration of peace	8000
		Less debt redeemed in 12 to 13 years ...	1000
		Balance net debt ...	7000
		Interest 4 % and 1 % sinking fund on 7000 millions ...	350
	<hr/> 650		<hr/> 650

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